UMPQUA HOLDINGS CORP
Form 10-Q
August 05, 2014

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended: June 30, 2014
or
[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from to .

Commission File Number: 001-34624

Umpqua Holdings Corporation

(Exact Name of Registrant as Specified in Its Charter)

OREGON	93-1261319
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

One SW Columbia Street, Suite 1200
Portland, Oregon 97258
(Address of Principal Executive Offices)(Zip Code)

(503) 727-4100
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

[X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

[X] Yes [ ] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

[X] Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

[ ] Yes [X] No

Indicate the number of shares outstanding for each of the issuer's classes of common stock, as of the latest practical date:

Common stock, no par value: 217,244,246 shares outstanding as of July 31, 2014

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)

UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except shares)

	June 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$347,152	$178,685
Interest bearing deposits and temporary investments (restricted cash of $37,149 and $13,384)	493,268	611,738
Total cash and cash equivalents	840,420	790,423
Investment securities		
Trading, at fair value	9,420	5,958
Available for sale, at fair value	2,588,969	1,790,978
Held to maturity, at amortized cost	5,519	5,563
Loans held for sale ($322,912 and $104,664 at fair value)	328,968	104,664
Non-covered loans and leases	14,830,345	7,354,403
Allowance for non-covered loan and lease losses	(97,995)	(85,314)
Net non-covered loans and leases	14,732,350	7,269,089
Covered loans, net of allowance of $8,500 and $9,771	297,610	363,992
Restricted equity securities	122,194	30,685
Premises and equipment, net	310,407	177,680
Goodwill	1,779,732	764,305
Other intangible assets, net	62,938	12,378
Residential mortgage servicing rights, at fair value	114,192	47,765
Non-covered other real estate owned	26,172	21,833
Covered other real estate owned	1,810	2,102
FDIC indemnification asset	11,293	23,174
Bank owned life insurance	292,714	96,938
Deferred tax asset, net	259,993	16,627
Other assets	257,528	111,958
Total assets	$22,042,229	$11,636,112
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest bearing	$4,363,710	$2,436,477
Interest bearing	11,959,290	6,681,183
Total deposits	16,323,000	9,117,660
Securities sold under agreements to repurchase	315,025	224,882
Term debt	1,057,915	251,494
Junior subordinated debentures, at fair value	246,077	87,274
Junior subordinated debentures, at amortized cost	101,737	101,899
Other liabilities	269,415	125,477
Total liabilities	18,313,169	9,908,686
COMMITMENTS AND CONTINGENCIES (NOTE 10)		
SHAREHOLDERS' EQUITY		
	3,512,507	1,514,485

Common stock, no par value, shares authorized: 400,000,000 in 2014 and 200,000,000 in 2013; issued and outstanding: 217,190,721 in 2014 and 111,973,203 in 2013		
Retained earnings	204,109	217,917
Accumulated other comprehensive income (loss)	12,444	(4,976)
Total shareholders' equity	3,729,060	1,727,426
Total liabilities and shareholders' equity	$22,042,229	$11,636,112

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
INTEREST INCOME				
Interest and fees on non-covered loans and leases	$193,061	$78,434	$284,329	$156,979
Interest and fees on covered loans and leases	15,931	14,750	28,649	29,330
Interest and dividends on investment securities:				
Taxable	12,699	8,103	21,990	16,747
Exempt from federal income tax	2,609	2,237	4,721	4,525
Dividends	128	90	178	114
Interest on temporary investments and interest bearing deposits	539	401	980	653
Total interest income	224,967	104,015	340,847	208,348
INTEREST EXPENSE				
Interest on deposits	6,075	5,864	9,923	11,742
Interest on securities sold under agreement to repurchase	203	33	244	64
Interest on term debt	3,364	2,305	5,637	4,578
Interest on junior subordinated debentures	3,066	1,920	4,946	3,882
Total interest expense	12,708	10,122	20,750	20,266
Net interest income	212,259	93,893	320,097	188,082
PROVISION FOR NON-COVERED LOAN AND LEASE LOSSES	15,399	2,993	20,799	9,981
RECAPTURE OF PROVISION FOR COVERED LOAN LOSSES	(703)	(3,072)	(132)	(2,840)
Net interest income after provision for loan and lease losses	197,563	93,972	299,430	180,941
NON-INTEREST INCOME				
Service charges on deposit accounts	15,371	7,478	23,138	14,470
Brokerage commissions and fees	4,566	3,662	8,291	7,298
Residential mortgage banking revenue, net	24,341	24,289	34,780	47,857
Gain on investment securities, net	976	8	976	15
Loss on junior subordinated debentures carried at fair value	(1,369)	(547)	(1,911)	(1,089)
Change in FDIC indemnification asset	(5,601)	(8,294)	(10,441)	(13,367)
BOLI income	1,967	910	2,703	1,670
Other income	4,278	6,991	10,000	11,658
Total non-interest income	44,529	34,497	67,536	68,512
NON-INTEREST EXPENSE				
Salaries and employee benefits	95,560	52,067	148,776	103,572
Net occupancy and equipment	28,746	15,059	45,247	29,794
Communications	4,166	2,827	7,068	6,030
Marketing	1,157	1,296	2,162	2,157
Services	12,402	6,001	18,391	11,894
FDIC assessments	2,575	1,672	4,438	3,323
Net loss (gain) on non-covered other real estate owned	178	(146)	160	(276)
Net loss (gain) on covered other real estate owned	80	(62)	34	222
Intangible amortization	2,808	1,205	4,002	2,409

Merger related expenses	57,531	810	63,514	2,341
Other expenses	8,928	7,202	16,857	12,227
Total non-interest expense	214,131	87,931	310,649	173,693
Income before provision for income taxes	27,961	40,538	56,317	75,760
Provision for income taxes	10,740	14,285	20,332	26,146
Net income	$17,221	$26,253	$35,985	$49,614

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Continued)
(UNAUDITED)

(in thousands, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	$17,221	$26,253	$35,985	$49,614
Dividends and undistributed earnings allocated to participating securities	83	197	196	380
Net earnings available to common shareholders	$17,138	$26,056	$35,789	$49,234
Earnings per common share:				
Basic	$0.09	$0.23	$0.23	$0.44
Diluted	$0.09	$0.23	$0.23	$0.44
Weighted average number of common shares outstanding:				
Basic	196,312	111,954	154,473	111,946
Diluted	197,638	112,145	155,276	112,133

See notes to condensed consolidated financial statements

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	$17,221	$26,253	$35,985	$49,614
Available for sale securities:				
Unrealized gains (losses) arising during the period	21,936	(36,793)	29,914	(41,220)
Reclassification adjustment for net gains realized in earnings (net of tax expense of $375 and $3 for the three months ended June 30, 2014 and 2013, respectively, and net of tax expense of $375 thousand and $6 for the six months ended June 30, 2014 and 2013, respectively)	(585)	(5)	(585)	(9)
Income tax (expense) benefit related to unrealized gains (losses)	(8,775)	14,717	(11,966)	16,488
Net change in unrealized gains (losses)	12,576	(22,081)	17,363	(24,741)
Held to maturity securities:				
Accretion of unrealized losses related to factors other than credit to investment securities held to maturity (net of tax benefit of $31 and $10 for the three months ended June 30, 2014 and 2013, respectively, and net of tax benefit of $37 and $21 for the six months ended June 30, 2014 and 2013, respectively)	47	14	57	32
Net change in unrealized losses related to factors other than credit	47	14	57	32
Other comprehensive income (loss), net of tax	12,623	(22,067)	17,420	(24,709)
Comprehensive income	$29,844	$4,186	$53,405	$24,905

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)

(in thousands, except shares)	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	Amount	Earnings	Income (Loss)	Total
BALANCE AT JANUARY 1, 2013	111,889,959	$1,512,400	$187,293	$24,346	$1,724,039
Net income			98,361		98,361
Other comprehensive loss, net of tax				(29,322)	(29,322)
Comprehensive income					$69,039
Stock-based compensation		5,017			5,017
Stock repurchased and retired	(584,677)	(9,360)			(9,360)
Issuances of common stock under stock plans and related net tax benefit	667,921	6,428			6,428
Cash dividends on common stock ($0.60 per share)			(67,737)		(67,737)
Balance at December 31, 2013	111,973,203	$1,514,485	$217,917	$(4,976)	$1,727,426
BALANCE AT JANUARY 1, 2014	111,973,203	$1,514,485	$217,917	$(4,976)	$1,727,426
Net income			35,985		35,985
Other comprehensive income, net of tax				17,420	17,420
Comprehensive income					$53,405
Stock issued in connection with merger (1)	104,385,087	1,989,030			1,989,030
Stock-based compensation		8,682			8,682
Stock repurchased and retired	(371,236)	(6,617)			(6,617)
Issuances of common stock under stock plans and related net tax benefit	1,203,667	6,927			6,927
Cash dividends on common stock ($0.30 per share)			(49,793)		(49,793)
Balance at June 30, 2014	217,190,721	$3,512,507	$204,109	$12,444	$3,729,060

(1) The amount of common stock issued in connection with the merger is net of $784,000 of issuance costs.

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Six Months Ended June 30,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$35,985	$49,614
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premiums, net	9,163	20,486
Gain on sale of investment securities, net	(976)	(15)
Loss (gain) on sale of non-covered other real estate owned	44	(713)
Loss (gain) on sale of covered other real estate owned	34	(457)
Valuation adjustment on non-covered other real estate owned	115	437
Valuation adjustment on covered other real estate owned	—	679
Provision for non-covered loan and lease losses	20,799	9,981
Recapture of provision for covered loan losses	(132)	(2,840)
Proceeds from bank owned life insurance	187	1,173
Change in cash surrender value of bank owned life insurance	(2,717)	(2,801)
Change in FDIC indemnification asset	10,441	13,367
Depreciation, amortization and accretion	47,300	8,921
Increase in residential mortgage servicing rights	(7,770)	(11,110)
Change in residential mortgage servicing rights carried at fair value	4,113	346
Change in junior subordinated debentures carried at fair value	2,631	1,078
Stock-based compensation	8,682	2,222
Net decrease (increase) in trading account assets	1,036	(116)
Gain on sale of loans	(27,833)	(47,116)
Change in loans held for sale carried at fair value	(12,594)	16,801
Origination of loans held for sale	(855,951)	(1,000,688)
Proceeds from sales of loans held for sale	810,613	1,174,397
Excess tax benefits from the exercise of stock options	(1,719)	(49)
Change in other assets and liabilities:		
Net (increase) decrease in other assets	(29,137)	29,545
Net increase (decrease) in other liabilities	37,487	(20,189)
Net cash provided by operating activities	49,801	242,953
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investment securities available for sale	(346,844)	(51,191)
Proceeds from investment securities available for sale	943,104	530,898
Proceeds from investment securities held to maturity	365	914
Redemption of restricted equity securities	2,755	1,331
Net non-covered loan and lease originations	(524,212)	(160,345)
Net covered loan paydowns	36,438	47,744
Proceeds from sales of non-covered loans	159,439	53,264
Proceeds from insurance settlement on loss of property	—	575
Proceeds from disposals of furniture and equipment	52	139
Purchases of premises and equipment	(22,656)	(16,514)
Net (payments) proceeds (to) from FDIC indemnification asset	(2,376)	3,065
Proceeds from sales of non-covered other real estate owned	7,000	11,210

Proceeds from sales of covered other real estate owned	298	8,126
Net cash paid in divestiture	(130,627)	—
Cash acquired in merger, net of cash consideration paid	116,867	—
Net cash provided by investing activities	$239,603	$429,216

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UMPQUA HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(UNAUDITED)

(in thousands)

	Six Months Ended June 30,	
	2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in deposit liabilities	$335,788	$(422,723)
Net (decrease) increase in securities sold under agreements to repurchase	(494,603)	39,372
Repayment of term debt	(47,004)	—
Repayment of junior subordinated debentures	—	(8,764)
Dividends paid on common stock	(33,883)	(16,931)
Excess tax benefits from stock based compensation	1,719	49
Proceeds from stock options exercised	5,193	846
Retirement of common stock	(6,617)	(2,811)
Net cash used by financing activities	(239,407)	(410,962)
Net increase in cash and cash equivalents	49,997	261,207
Cash and cash equivalents, beginning of period	790,423	543,787
Cash and cash equivalents, end of period	$840,420	$804,994
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$21,957	$21,825
Income taxes	$6,486	$13,100
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Change in unrealized gains (losses) on investment securities available for sale, net of taxes	$17,363	$(24,741)
Change in unrealized losses on investment securities held to maturity related to factors other than credit, net of taxes	$57	$32
Cash dividend declared on common stock and payable after period-end	$32,674	$16,907
Transfer of non-covered loans to non-covered other real estate owned	$3,358	$7,032
Transfer of covered loans to covered other real estate owned	$40	$2,554
Transfer of covered loans to non-covered loans	$2,053	$10,560
Transfer from FDIC indemnification asset to due from FDIC and other	$1,440	$3,168
Receivable from sales of covered other real estate owned	$—	$1,096
Acquisitions:		
Assets acquired, including goodwill of $1,015,427	$9,879,425	$—
Liabilities assumed	$8,762,385	$—

See notes to condensed consolidated financial statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – Summary of Significant Accounting Policies

The accounting and financial reporting policies of Umpqua Holdings Corporation conform to accounting principles generally accepted in the United States of America. The accompanying interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material inter-company balances and transactions have been eliminated. The condensed consolidated financial statements have not been audited. A more detailed description of our accounting policies is included in the 2013 Annual Report filed on Form 10-K. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the 2013 Annual Report filed on Form 10-K. All references in this report to "Umpqua," "we," "our," "us," the "Company" or similar references mean Umpqua Holdings Corporation and its successors, and include our consolidated subsidiaries where the context so requires. References to "Bank" refer to our subsidiary Umpqua Bank, an Oregon state-chartered commercial bank, and references to "Umpqua Investments" refer to our subsidiary Umpqua Investments, Inc., a registered broker-dealer and investment adviser. The Bank also has a wholly-owned subsidiary, Financial Pacific Leasing Inc., a commercial equipment leasing company.

In preparing these condensed consolidated financial statements, the Company has evaluated events and transactions subsequent to June 30, 2014 for potential recognition or disclosure. In management's opinion, all accounting adjustments necessary to accurately reflect the financial position and results of operations on the accompanying financial statements have been made. These adjustments include normal and recurring accruals considered necessary for a fair and accurate presentation. The results for interim periods are not necessarily indicative of results for the full year or any other interim period. Certain reclassifications of prior period amounts have been made to conform to current classifications.

Note 2 – Business Combinations

Sterling Financial Corporation
As of the close of business on April 18, 2014, the Company completed its merger with Sterling Financial Corporation, a Washington corporation ("Sterling"). The results of Sterling's operations are included in the Company's financial results beginning April 19, 2014 and the combined company's banking operations are operating under the Umpqua Bank name and brand.

The structure of the transaction was as follows:

- Sterling merged with and into the Company (the "Merger" or the "Sterling merger") with the Company as the surviving corporation in the Merger;
- Immediately following the Merger, Sterling's wholly owned banking subsidiary, Sterling Savings Bank merged with and into the Bank (the "Bank Merger"), with the Bank as the surviving bank in the Bank Merger;
- Holders of shares of common stock of Sterling had the right to receive 1.671 shares of the Company's common stock and $2.18 in cash for each share of Sterling common stock;
- Each outstanding warrant issued by Sterling converted into a warrant exercisable for 1.671 shares of the Company's common stock and $2.18 in cash for each warrant when exercised;
- Each outstanding option to purchase a share of Sterling common stock converted into an option to purchase 1.7896 shares of Company's common stock, subject to vesting conditions; and
- Each outstanding restricted stock unit in respect of Sterling common stock converted into a restricted stock unit in respect of 1.7896 shares the Company common stock, subject to vesting conditions.

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A summary of the consideration paid, the assets acquired and liabilities assumed in the Merger are presented below:
(in thousands)

	Sterling April 18, 2014	
Fair value of consideration to Sterling shareholders:		
Cash paid		$136,200
Liability recorded for warrants' cash payment per share		6,453
Fair value of common shares issued		1,939,497
Fair value of warrants, common stock options, and restricted stock exchanged		50,317
Total consideration		2,132,467
Fair value of assets acquired:		
Cash and cash equivalents	$253,067	
Investment securities	1,378,300	
Loans held for sale	215,208	
Non-covered loans and leases	7,122,989	
Premises and equipment	124,881	
Residential mortgage servicing rights	62,770	
Other intangible assets	54,562	
Non-covered other real estate owned	8,140	
Bank owned life insurance	193,246	
Deferred tax asset	295,371	
Accrued interest receivable	23,553	
Other assets	147,338	
Total assets acquired	9,879,425	
Fair value of liabilities assumed:		
Deposits	7,086,052	
Securities sold under agreements to repurchase	584,746	
Term debt	854,737	
Junior subordinated debentures	156,171	
Other liabilities	80,679	
Total liabilities assumed	$8,762,385	
Net assets acquired		1,117,040
Preliminary goodwill		$1,015,427

Amounts recorded are preliminary estimates of fair value. The primary reason for the Merger was to continue the Company's growth strategy, including expanding our geographic footprint in markets throughout the West Coast. All of the goodwill recorded has been attributed to the Community Banking segment and reporting unit. None of the goodwill will be deductible for income tax purposes.

Subsequent to acquisition, the Company repaid securities sold under agreements to repurchase acquired of $500.0 million, funded through the sale of acquired investment securities in the second quarter of 2014. On June 20, 2014, the Company completed the required divestiture of six stores acquired in the Merger to another financial institution. The divestiture of the six stores included $211.5 million of deposits and $88.3 million of loans. The assets were sold at a discount of $7.0 million, which was recorded by Sterling prior to the merger.

As of April 18, 2014, the unpaid principal balance on purchased non-impaired loans was $7.0 billion. The fair value of the purchased non-impaired loans was $6.7 billion, resulting in a discount of $230.5 million being recorded on these loans.

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The following table presents the acquired purchased impaired loans as of the acquisition date:

(in thousands)	Purchase impaired
Contractually required principal payments	$604,136
Nonaccretable difference	(95,614)
Cash flows expected to be collected	508,522
Accretable yield	(110,757)
Fair value of purchased non-covered impaired loans	$397,765

The operations of Sterling are included in our operating results beginning on April 19, 2014, and contributed the following net interest income, provision for loan losses, non-interest income and expense, income tax benefit, and net income for the three and six months ended June 30, 2014.

(in thousands)	Sterling Stand-alone	
	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Net interest income	$101,254	$101,254
Provision for loan losses	7,735	7,735
Non-interest income	22,302	22,302
Non-interest expense, excluding merger expense	65,132	65,132
Merger expense	57,531	57,531
Income tax benefit	1,101	1,101
Net loss	$(5,741)	$(5,741)

The following table provides a breakout of Merger related expense for the three and six months ended June 30, 2014.

(in thousands)	Three Months Ended June 30, 2014	Six Months Ended June 30, 2014
Personnel	$15,075	$15,488
Legal and professional	8,752	13,924
Charitable contributions	10,000	10,000
Investment banking fees	9,573	9,573
Contract termination	8,853	8,853
Communication	1,839	2,011
Other	3,439	3,665
Total Merger related expense	$57,531	$63,514

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The following table presents unaudited pro forma results of operations for the three and six months ended June 30, 2014 and 2013, as if the Sterling merger had occurred on January 1, 2013. The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013. The pro forma results include the impact of certain purchase accounting adjustments including accretion of loan discount, intangible assets amortization and deposit and borrowing premium accretion. These purchase accounting adjustments increased pro forma net income by $2.8 million and $20.4 million for the three months ended June 30, 2014 and 2013, respectively, and $23.4 million and $42.5 million for the six months ended June 30, 2014 and 2013, respectively.

(in thousands, except per share data)

	Pro Forma Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Net interest income	$234,503	$214,107	$458,792	$427,140	(1), (2)
Provision for non-covered loan and lease losses	15,399	2,993	20,799	9,981	
Recapture of provision for covered loan losses	(703)	(3,072)	(132)	(2,840)	
Non-interest income	48,785	71,567	94,107	138,718	(3), (4), (5)
Non-interest expense	175,480	241,906	349,705	419,915	(6), (7)
Income before provision for income taxes	93,112	43,847	182,527	138,802	
Provision for income taxes	36,637	12,822	68,905	45,039	
Net income	56,475	31,025	113,622	93,763	
Dividends and undistributed earnings allocated to participating securities	83	197	196	380	
Net earnings available to common shareholders	$56,392	$30,828	$113,426	$93,383	
Earnings per share:					
Basic	$0.26	$0.14	$0.52	$0.43	
Diluted	$0.26	$0.14	$0.52	$0.43	
Average shares outstanding:					
Basic	216,960	216,040	216,700	215,992	
Diluted	220,531	218,476	219,748	218,424	

(1) Includes $5.1 million and $33.6 million of incremental loan discount accretion for the three months ended June 30, 2014 and 2013, respectively and $31.9 million and $69.8 million for the six months ended June 30, 2014 and 2013, respectively.
(2) Includes a reduction of interest expense of $1.0 million and $5.6 million related to deposit and borrowing premiums amortization for the three months ended June 30, 2014 and 2013, respectively and $5.9 million and $11.4 million for the six months ended June 30, 2014 and 2013, respectively.
(3) Includes a reduction of service charges on deposit of $288,000 and $1.4 million as a result of passing the $10 billion asset threshold for the three months ended June 30, 2014 and 2013, respectively and $1.7 million and $2.9 million for the six months ended June 30, 2014 and 2013, respectively.
(4) Includes a loss on junior subordinated debentures carried at fair value of $190,000 and $966,000 for the three months ended June 30, 2014 and 2013, respectively and $837,000 and $1.9 million for six months ended June 30, 2014 and 2013, respectively.
(5) The six months ended June 30, 2014 includes the reversal of the $7.0 million loss on the sale of the six stores.
(6) Includes $347,000 and $2.0 million of incremental core deposit intangible amortization for the three months ended June 30, 2014 and 2013, respectively and $2.1 million and $4.1 million for the six months ended June 30, 2014 and 2013, respectively.

(7) The three and six months ended June 30, 2014 were adjusted to exclude $70.7 million and $79.4 million of merger expenses, respectively, the three and six months ended June 2013 were adjusted to include these charges.

Financial Pacific Holding Corp.
On July 1, 2013, the Bank acquired Financial Pacific Holding Corp. ("FPHC") based in Federal Way, Washington, and its subsidiary, Financial Pacific Leasing, Inc. ("FinPac Leasing"), and its subsidiaries, Financial Pacific Funding, Inc. ("FPF"), Financial Pacific Funding II, Inc. ("FPF II") and Financial Pacific Funding III, Inc. ("FPF III"). As part of the same transaction,

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the Company acquired two related entities, FPC Leasing Corporation ("FPC") and Financial Pacific Reinsurance Co., Ltd. ("FPR"). FPHC, FinPac Leasing, FPF, FPF II, FPF III, FPC and FPR are collectively referred to herein as "FinPac." FinPac provides business-essential commercial equipment leases to various industries throughout the United States and Canada. It originates leases through its brokers, lessors, and direct marketing programs. The results of FinPac's operations are included in the consolidated financial statements as of July 1, 2013.

The aggregate consideration for the FinPac purchase was $158.0 million. Of that amount, $156.1 million was distributed in cash, and $1.9 million was exchanged for restricted shares of the Company stock. The restricted shares were issued from the Company's 2013 Incentive Plan pursuant to employment agreements between the Company's and certain executives of FinPac, vest over a period of either two or three years, and will be recognized over that time period within the salaries and employee benefits line item on the Consolidated Statements of Income. The structure of the transaction was as follows:

- The Bank acquired all of the outstanding stock of FPHC, a shell holding company, which is the sole shareholder of FinPac Leasing, the primary operating subsidiary of FinPac that engages in equipment leasing and financing activities. FinPac Leasing is also the sole shareholder of FPF, FPF II and FPF III, which are bankruptcy-remote entities that formerly served as lien holder for certain leases. FPF, FPF II and FPF III have no assets or current business activities and are in the process of dissolution. Upon the dissolution of FPHC, the Bank will hold all of the outstanding stock of FinPac Leasing.
- The Company acquired all of the outstanding stock of FPC, a Canadian leasing subsidiary, and FPR, a corporation organized in the Turks & Caicos Islands that reinsures a portion of the liability risk of each insurance policy that is issued by a third party insurance company on leased equipment when the lessee fails to meet its contractual obligations under the lease or financing agreement to obtain insurance on the leased equipment.

A summary of consideration paid, the assets acquired and liabilities assumed at their fair values in the acquisition of FinPac are presented below.
(in thousands)

	FinPac July 1, 2013	
Fair value of consideration:		
Cash		$156,110
Fair value of assets acquired:		
Cash and equivalents	$6,452	
Non-covered loans and leases, net	264,336	
Premises and equipment	491	
Other assets	8,015	
Total assets acquired	279,294	
Fair value of liabilities assumed:		
Term debt	211,204	
Other liabilities	8,757	
Total liabilities assumed	$219,961	
Net assets acquired		59,333
Goodwill		$96,777

The acquisition provides diversification, and a scalable platform that is consistent with expansion initiatives that the Bank has completed over the last three years, including growth in the business banking, agricultural lending and home builder lending groups. The transaction leverages excess capital of the Company and deploys excess liquidity into significantly higher yielding assets, provides growth and diversification, and is anticipated to increase profitability. There is no tax deductible goodwill or other intangibles.

The operations of FinPac are included in our operating results from July 1, 2013, and added revenue of $15.9 million, non-interest expense of $3.7 million , and net income of $3.9 million net of tax, for the three months ended June 30, 2014. For the six months ended June 30, 2014, FinPac added revenue of $31.5 million, non-interest expense of $7.6 million, and net income of $8.2 million, net of tax. FinPac's results of operations prior to the acquisition are not included in our operating results. There

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are no FinPac merger related expenses for the three and six months ended June 30, 2014. FinPac merger related expenses were $654,000 and $796,000 for the three and six months ended June 30, 2013.

Non-covered leases acquired from FinPac are presented below as of acquisition date:

(in thousands)	FinPac July 1, 2013
Contractually required payments	$350,403
Purchase adjustment for credit	$(20,520)
Balance of non-covered impaired leases, net	$264,336

The following table presents unaudited pro forma results of operations for the three and six months ended June 30, 2013 as if the acquisition of FinPac had occurred on January 1, 2013. The proforma results have been prepared for comparative purposes only and are not necessarily indicative of the results that would have been obtained had the acquisition actually occurred on January 1, 2013. The pro forma results include the impact of certain purchase accounting adjustments which reduced pro forma earnings available to common shareholders by $820,000 and $1.5 million for the three and six months ended June 30, 2013, respectively.

(in thousands, except per share data)	Pro Forma	
	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Net interest income	$105,297	$210,809
Provision for non-covered loan and lease losses	3,688	13,253
Recapture of provision for covered loan losses	(3,072)	(2,840)
Non-interest income	35,019	69,824
Non-interest expense	92,403	181,794
Income before provision for income taxes	47,297	88,426
Provision for income taxes	16,910	31,094
Net income	30,387	57,332
Dividends and undistributed earnings allocated to participating securities	228	439
Net earnings available to common shareholders	$30,159	$56,893
Earnings per share:		
Basic	$0.27	$0.51
Diluted	$0.27	$0.51
Average shares outstanding:		
Basic	111,954	111,946
Diluted	112,145	112,133

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Note 3 – Investment Securities

The following table presents the amortized costs, unrealized gains, unrealized losses and approximate fair values of investment securities at June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$214	$19	$—	$233
Obligations of states and political subdivisions	336,607	13,428	(1,056)	348,979
Residential mortgage-backed securities and collateralized mortgage obligations	2,229,391	22,995	(14,645)	2,237,741
Investments in mutual funds and other equity securities	2,016	—	—	2,016
	$2,568,228	$36,442	$(15,701)	$2,588,969
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,375	$306	$(42)	$5,639
Other investment securities	144	—	—	144
	$5,519	$306	$(42)	$5,783

(in thousands)	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
AVAILABLE FOR SALE:				
U.S. Treasury and agencies	$249	$20	$(1)	$268
Obligations of states and political subdivisions	229,969	7,811	(2,575)	235,205
Residential mortgage-backed securities and collateralized mortgage obligations	1,567,001	15,359	(28,819)	1,553,541
Investments in mutual funds and other equity securities	1,959	5	—	1,964
	$1,799,178	$23,195	$(31,395)	$1,790,978
HELD TO MATURITY:				
Residential mortgage-backed securities and collateralized mortgage obligations	$5,563	$330	$(19)	$5,874
	$5,563	$330	$(19)	$5,874

Investment securities that were in an unrealized loss position as of June 30, 2014 and December 31, 2013 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

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June 30, 2014 (in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
Obligations of states and political subdivisions	$7,145	$647	$24,892	$409	$32,037	$1,056
Residential mortgage-backed securities and collateralized mortgage obligations	249,624	582	557,774	14,063	807,398	14,645
Total temporarily impaired securities	$256,769	$1,229	$582,666	$14,472	$839,435	$15,701
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$210	$42	$—	$—	$210	$42
Total temporarily impaired securities	$210	$42	$—	$—	$210	$42

Unrealized losses on the impaired held to maturity collateralized mortgage obligations include the unrealized losses related to factors other than credit that are included in other comprehensive income.

December 31, 2013 (in thousands)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
AVAILABLE FOR SALE:						
U.S. Treasury and agencies	$—	$—	$32	$1	$32	$1
Obligations of states and political subdivisions	48,342	2,575	—	—	48,342	2,575
Residential mortgage-backed securities and collateralized mortgage obligations	475,982	15,951	249,695	12,868	725,677	28,819
Total temporarily impaired securities	$524,324	$18,526	$249,727	$12,869	$774,051	$31,395
HELD TO MATURITY:						
Residential mortgage-backed securities and collateralized mortgage obligations	$156	$19	$—	$—	$156	$19
Total temporarily impaired securities	$156	$19	$—	$—	$156	$19

The unrealized losses on investments in U.S. Treasury and agency securities were caused by interest rate increases subsequent to the purchase of these securities. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than par. Because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired ("OTTI").

The unrealized losses on obligations of political subdivisions were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities. Management monitors published credit ratings of these securities and no adverse ratings changes have occurred since the date of purchase of obligations of political subdivisions which are in an unrealized loss position as of June 30, 2014. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until maturity, the unrealized losses on these investments are not considered OTTI.

All of the available for sale residential mortgage-backed securities and collateralized mortgage obligations portfolio in an unrealized loss position at June 30, 2014 are issued or guaranteed by governmental agencies. The unrealized losses on residential mortgage-backed securities and collateralized mortgage obligations were caused by changes in market interest rates or the widening of market spreads subsequent to the initial purchase of these securities, and not concerns regarding the underlying credit of the issuers or the underlying collateral. It is expected that these securities will not be settled at a price less than the amortized cost of each investment. Because the decline in fair value is attributable to changes in interest rates or widening market spreads and not credit quality, and because the Bank does not intend to sell the securities in this class and it is

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not likely that the Bank will be required to sell these securities before recovery of their amortized cost basis, which may include holding each security until contractual maturity, these investments are not considered OTTI.

The following table presents the maturities of investment securities at June 30, 2014:

(in thousands)	Available For Sale		Held To Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
AMOUNTS MATURING IN:				
Three months or less	$11,267	$11,314	$—	$—
Over three months through twelve months	40,413	40,990	5	5
After one year through five years	1,522,689	1,548,906	27	28
After five years through ten years	887,929	879,608	29	31
After ten years	103,914	106,135	5,314	5,575
Other investment securities	2,016	2,016	144	144
	$2,568,228	$2,588,969	$5,519	$5,783

The amortized cost and fair value of collateralized mortgage obligations and mortgage-backed securities are presented by expected average life, rather than contractual maturity, in the preceding table. Expected maturities may differ from contractual maturities because borrowers have the right to prepay underlying loans without prepayment penalties. The following table presents the gross realized gains and gross realized losses on the sale of securities available for sale for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended			
	June 30, 2014		June 30, 2013	
	Gains	Losses	Gains	Losses
Obligations of states and political subdivisions	$3	$1	$—	$1
Residential mortgage-backed securities and collateralized mortgage obligations	974	—	—	—
Other debt securities	—	—	9	—
	$977	$1	$9	$1

	Six Months Ended			
	June 30, 2014		June 30, 2013	
	Gains	Losses	Gains	Losses
Obligations of states and political subdivisions	$3	$1	$7	$1
Residential mortgage-backed securities and collateralized mortgage obligations	974	—	—	—
Other debt securities	—	—	9	—
	$977	$1	$16	$1

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The following table presents, as of June 30, 2014, investment securities which were pledged to secure borrowings, public deposits, and repurchase agreements as permitted or required by law:

(in thousands)	Amortized Cost	Fair Value
To Federal Home Loan Bank to secure borrowings	$8,290	$8,634
To state and local governments to secure public deposits	1,674,935	1,687,353
Other securities pledged principally to secure repurchase agreements	460,240	459,421
Total pledged securities	$2,143,465	$2,155,408

Note 4 – Non-Covered Loans and Leases

The following table presents the major types of non-covered loans and leases, net as of June 30, 2014 and December 31, 2013, respectively:

(in thousands)	June 30, 2014	December 31, 2013
Commercial real estate		
Non-owner occupied term, net	$3,348,029	$2,328,260
Owner occupied term, net	2,666,128	1,259,583
Multifamily, net	2,482,995	403,537
Construction & development, net	261,767	245,231
Residential development, net	91,690	88,413
Commercial		
Term, net	1,104,206	770,845
LOC & other, net	1,322,167	987,360
Leases and equipment finance, net	463,784	361,591
Residential		
Mortgage, net	1,958,597	597,201
Home equity loans & lines, net	799,171	264,269
Consumer & other, net	331,811	48,113
Total loans and leases, net of deferred fees and costs	$14,830,345	$7,354,403

The non-covered loan balances are net of net deferred loan costs of $13.5 million as of June 30, 2014 and net of net deferred loan fees of $495,000 at December 31, 2013. Net non-covered loans include discounts on acquired loans of $287.4 million and $3.3 million as of June 30, 2014 and December 31, 2013, respectively. As of June 30, 2014, non-covered loans totaling $8.6 billion were pledged to secure borrowings and available lines of credit.

Purchased loans and leases are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan and lease losses is not recorded at the acquisition date. Acquired loans are evaluated upon acquisition and classified as either purchased impaired or purchased non-impaired. Purchased impaired loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. The outstanding contractual unpaid principal balance of non-covered purchased impaired loans, excluding purchase accounting adjustments, was $511.2 million and $35.1 million at June 30, 2014 and December 31, 2013, respectively. The carrying balance of non-covered purchased impaired loans was $402.5 million and $21.9 million at June 30, 2014 and December 31, 2013, respectively.

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The following table presents the changes in the accretable yield for purchased impaired loans for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$1,053	$667	$1,140	$770
Additions	110,757	—	110,757	—
Accretion to interest income	(5,990)	(73)	(6,077)	(151)
Disposals	(315)	(424)	(315)	(449)
Reclassifications from nonaccretable difference	—	—	—	—
Balance, end of period	$105,505	$170	$105,505	$170

Note 5 – Allowance for Non-Covered Loan and Lease Loss and Credit Quality

The Bank's methodology for assessing the appropriateness of the Allowance for Loan and Lease Loss "ALLL" consists of three key elements, which includes 1) the formula allowance; 2) the specific allowance; and 3) the unallocated allowance. By incorporating these factors into a single allowance requirement analysis, all risk-based activities within the loan and lease portfolios are simultaneously considered.

Formula Allowance

When loans and leases are originated, they are assigned a risk rating that is reassessed periodically during the term of the loan or lease through the credit review process. The Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating categories are a primary factor in determining an appropriate amount for the formula allowance.

The formula allowance is calculated by applying risk factors to various segments of pools of outstanding loans and leases. Risk factors are assigned to each portfolio segment based on management's evaluation of the losses inherent within each segment. Segments or regions with greater risk of loss will therefore be assigned a higher risk factor.

Base risk – The portfolio is segmented into loan categories, and these categories are assigned a Base risk factor based on an evaluation of the loss inherent within each segment.

Extra risk – Additional risk factors provide for an additional allocation of ALLL based on the loan and lease risk rating system and loan delinquency, and reflect the increased level of inherent losses associated with more adversely classified loans and leases.

Risk factors may be changed periodically based on management's evaluation of the following factors: loss experience; changes in the level of non-performing loans and leases; regulatory exam results; changes in the level of adversely classified loans and leases; improvement or deterioration in local economic conditions; and any other factors deemed relevant.

Specific Allowance

Regular credit reviews of the portfolio identify loans that are considered potentially impaired. Potentially impaired loans are referred to the ALLL Committee which reviews and approves designated loans as impaired. A loan is considered impaired, when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral. In these cases, we use the current fair value of the collateral, less selling costs, instead of discounted cash flows. If we determine that the value of the impaired loan is less than the

recorded investment in the loan, we either recognize an impairment reserve as a specific allowance to be provided for in the allowance for loan and lease losses or charge-off the impaired balance on collateral-dependent loans if it is determined that such amount represents a confirmed loss. Loans determined to be impaired with a specific allowance are excluded from the formula allowance so as not to double-count the loss exposure. The non-accrual impaired loans as of period end have already been partially charged-off to their estimated net realizable value, and are expected to be resolved over the coming quarters with no additional material loss, absent further decline in market prices.

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The combination of the formula allowance component and the specific allowance component represents the allocated allowance for loan and lease losses.

Unallocated Allowance

The Bank may also maintain an unallocated allowance amount to provide for other credit losses inherent in a loan and lease portfolio that may not have been contemplated in the credit loss factors. This unallocated amount generally comprises less than 5% of the allowance, but may be maintained at higher levels during times of deteriorating economic conditions characterized by falling real estate values. The unallocated amount is reviewed quarterly based on trends in credit losses, the results of credit reviews, overall economic trends and other qualitative factors.

Management believes that the ALLL was adequate as of June 30, 2014. There is, however, no assurance that future loan and lease losses will not exceed the levels provided for in the ALLL and could possibly result in additional charges to the provision for loan and lease losses.

The reserve for unfunded commitments ("RUC") is established to absorb inherent losses associated with our commitment to lend funds, such as with a letter or line of credit. The adequacy of the ALLL and RUC are monitored on a regular basis and are based on management's evaluation of numerous factors. These factors include the quality of the current loan portfolio; the trend in the loan portfolio's risk ratings; current economic conditions; loan concentrations; loan growth rates; past-due and non-performing trends; evaluation of specific loss estimates for all significant problem loans; historical charge-off and recovery experience; and other pertinent information.

There have been no significant changes to the Bank's ALLL methodology or policies in the periods presented.

Activity in the Non-Covered Allowance for Loan and Lease Losses

The following table summarizes activity related to the allowance for non-covered loan and lease losses by non-covered loan and lease portfolio segment for three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$51,847	$26,762	$7,191	$909	$86,709
Charge-offs	(629)	(4,418)	(449)	(318)	(5,814)
Recoveries	532	979	120	70	1,701
Provision	208	9,264	4,541	1,386	15,399
Balance, end of period	$51,958	$32,587	$11,403	$2,047	$97,995

	Three Months Ended June 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$55,095	$21,661	$7,219	$717	$84,692
Charge-offs	(2,038)	(1,614)	(728)	(224)	(4,604)
Recoveries	1,480	1,086	87	102	2,755
Provision	712	454	1,672	155	2,993
Balance, end of period	$55,249	$21,587	$8,250	$750	$85,836

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(in thousands)	Six Months Ended June 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$53,433	$24,191	$6,827	$863	$85,314
Charge-offs	(2,524)	(7,767)	(582)	(506)	(11,379)
Recoveries	971	1,960	167	163	3,261
Provision	78	14,203	4,991	1,527	20,799
Balance, end of period	$51,958	$32,587	$11,403	$2,047	$97,995

	Six Months Ended June 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$54,909	$22,925	$6,925	$632	$85,391
Charge-offs	(3,492)	(7,788)	(1,632)	(417)	(13,329)
Recoveries	1,950	1,453	179	211	3,793
Provision	1,882	4,997	2,778	324	9,981
Balance, end of period	$55,249	$21,587	$8,250	$750	$85,836

The following table presents the allowance and recorded investment in non-covered loans and leases by portfolio segment and balances as of June 30, 2014 and 2013:

(in thousands)	June 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for non-covered loans and leases:					
Collectively evaluated for impairment	$50,656	$32,572	$11,403	$2,047	$96,678
Individually evaluated for impairment	1,302	15	—	—	1,317
Loans acquired with deteriorated credit quality	—	—	—	—	—
Total	$51,958	$32,587	$11,403	$2,047	$97,995
Non-covered loans and leases:					
Collectively evaluated for impairment	$8,451,692	$2,818,710	$2,711,158	$330,291	$14,311,851
Individually evaluated for impairment	92,676	23,274	—	—	115,950
Loans acquired with deteriorated credit quality	306,241	48,173	46,610	1,520	402,544
Total	$8,850,609	$2,890,157	$2,757,768	$331,811	$14,830,345

(in thousands)	June 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for non-covered loans and leases:					
Collectively evaluated for impairment	$53,400	$21,583	$8,239	$750	$83,972
Individually evaluated for impairment	1,849	4	11	—	1,864
Total	$55,249	$21,587	$8,250	$750	$85,836
Non-covered loans and leases:					
Collectively evaluated for impairment	$4,112,263	$1,749,697	$766,578	$42,016	$6,670,554
Individually evaluated for impairment	111,814	15,045	477	—	127,336
Total	$4,224,077	$1,764,742	$767,055	$42,016	$6,797,890

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The non-covered loan and lease balances are net of net deferred loans costs of $13.5 million at June 30, 2014 and net of net deferred fees of $10.8 million at June 30, 2013.

Summary of Reserve for Unfunded Commitments Activity

The following table presents a summary of activity in the RUC and unfunded commitments for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$1,417	$1,269	$1,436	$1,223
Net change to other expense	(538)	58	(557)	104
Acquired reserve	3,966	—	3,966	—
Balance, end of period	$4,845	$1,327	$4,845	$1,327

(in thousands)	
	Total
Unfunded loan and lease commitments:	
June 30, 2014	$2,814,549
June 30, 2013	$1,553,657

Non-covered loans and leases sold

In the course of managing the loan and lease portfolio, at certain times, management may decide to sell loans and leases. The following table summarizes loans and leases sold by loan portfolio during the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Commercial real estate				
Non-owner occupied term	$11,606	$—	$14,799	$—
Owner occupied term	46,097		48,244	2,850
Multifamily	25,202		25,202	—
Construction & development	566	—	566	3,515
Residential development	195	340	800	363
Commercial				
Term	9,873	35,411	25,869	46,536
LOC & other	5,062	—	5,062	—
Residential				
Mortgage	5,703	—	6,034	—
Home equity loans & lines	24,445	—	24,445	—
Consumer & other	7,344	—	7,344	—
Total	$136,093	$35,751	$158,365	$53,264

Asset Quality and Non-Performing Loans and Leases

We manage asset quality and control credit risk through diversification of the non-covered loan and lease portfolio and the application of policies designed to promote sound underwriting and loan and lease monitoring practices. The

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Quality Group is charged with monitoring asset quality, establishing credit policies and procedures and enforcing the consistent application of these policies and procedures across the Bank. Reviews of non-performing, past due non-covered loans and leases and larger credits, designed to identify potential charges to the allowance for loan and lease losses, and to determine the adequacy of the allowance, are conducted on an ongoing basis. These reviews consider such factors as the financial strength of borrowers, the value of the applicable collateral, loan and lease loss experience, estimated loan and lease losses, growth in the loan and lease portfolio, prevailing economic conditions and other factors.

A loan is considered impaired when based on current information and events, we determine that we will probably not be able to collect all amounts due according to the loan contract, including scheduled interest payments. When we identify a loan as impaired, we measure the impairment using discounted cash flows, except when the sole remaining source of the repayment for the loan is the liquidation of the collateral.

Non-Covered Non-Accrual Loans and Leases and Loans and Leases Past Due

The following table summarizes our non-covered non-accrual loans and leases and loans and leases past due, by loan and lease class, as of June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014						
	Greater than 30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater and Accruing	Total Past Due	Non-Accrual	Current & Other (1)	Total non-cover Loans and Leases
Commercial real estate							
Non-owner occupied term, net	$907	$3,242	$298	$4,447	$ 17,689	$3,325,893	$3,348,029
Owner occupied term, net	2,700	6,018	—	8,718	4,442	2,652,968	2,666,128
Multifamily, net	—	516	—	516	1,311	2,481,168	2,482,995
Construction & development, net	—	1,804	—	1,804	—	259,963	261,767
Residential development, net	—	—	—	—	—	91,690	91,690
Commercial							
Term, net	443	512	—	955	19,142	1,084,109	1,104,206
LOC & other, net	1,534	952	225	2,711	2,587	1,316,869	1,322,167
Leases and equipment finance, net	1,156	1,343	638	3,137	3,153	457,494	463,784
Residential							
Mortgage, net	94	4,001	2,889	6,984	—	1,951,613	1,958,597
Home equity loans & lines, net	1,555	417	830	2,802	—	796,369	799,171
Consumer & other, net	1,331	388	39	1,758	34	330,019	331,811
Total, net of deferred fees and costs	$9,720	$19,193	$4,919	$33,832	$ 48,358	$14,748,155	$14,830,345

(1) Other includes purchased impaired non-covered loans of $402.5 million.

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(in thousands)	December 31, 2013						
	Greater than 30 to 59 Days Past Due	60 to 89 Days Past Due	90 Days and Greater and Accruing	Total Past Due	Non-Accrual	Current & Other (1)	Total non-cover Loans and Leases
Commercial real estate							
Non-owner occupied term, net	$3,618	$352	$—	$3,970	$ 9,193	$2,315,097	$2,328,260
Owner occupied term, net	1,320	340	610	2,270	6,204	1,251,109	1,259,583
Multifamily, net	—	—	—	—	935	402,602	403,537
Construction & development, net	—	—	—	—	—	245,231	245,231
Residential development, net	—	—	—	—	2,801	85,612	88,413
Commercial							
Term, net	901	1,436	—	2,337	8,723	759,785	770,845
LOC & other, net	619	224	—	843	1,222	985,295	987,360
Leases and equipment finance, net	2,202	1,706	517	4,425	2,813	354,353	361,591
Residential							
Mortgage, net	1,050	342	2,070	3,462	—	593,739	597,201
Home equity loans & lines, net	473	563	160	1,196	—	263,073	264,269
Consumer & other, net	69	75	73	217	—	47,896	48,113
Total, net of deferred fees and costs	$10,252	$5,038	$3,430	$18,720	$ 31,891	$7,303,792	$7,354,403

(1) Other includes purchased impaired non-covered loans of $21.9 million

Non-Covered Impaired Loans

Loans with no related allowance reported generally represent non-accrual loans. The Bank recognizes the charge-off on impaired loans in the period it arises for collateral-dependent loans. Therefore, the non-accrual loans as of June 30, 2014 have already been written-down to their estimated net realizable value and are expected to be resolved with no additional material loss, absent further decline in market prices. The valuation allowance on impaired loans primarily represents the impairment reserves on performing restructured loans, and is measured by comparing the present value of expected future cash flows on the restructured loans discounted at the interest rate of the original loan agreement to the loan's carrying value.

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The following table summarizes our non-covered impaired loans by loan class as of June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014			
	Unpaid	Recorded Investment		
	Principal	Without	With	Related
	Balance	Allowance	Allowance	Allowance
Commercial real estate				
Non-owner occupied term, net	$55,179	$28,444	$23,680	$651
Owner occupied term, net	12,349	5,026	7,114	452
Multifamily, net	5,185	1,311	3,519	86
Construction & development, net	10,505	8,393	1,091	9
Residential development, net	14,103	6,487	7,611	104
Commercial				
Term, net	28,874	19,142	300	11
LOC & other, net	7,619	2,587	1,245	4
Leases, net	—	—	—	—
Residential				
Mortgage, net	—	—	—	—
Home equity loans & lines, net	329	—	—	—
Consumer & other, net	153	—	—	—
Total, net of deferred fees and costs	$134,296	$71,390	$44,560	$1,317

(in thousands)	December 31, 2013			
	Unpaid	Recorded Investment		
	Principal	Without	With	Related
	Balance	Allowance	Allowance	Allowance
Commercial real estate				
Non-owner occupied term, net	$50,602	$18,285	$31,362	$928
Owner occupied term, net	11,876	6,204	5,202	198
Multifamily, net	1,416	935	—	—
Construction & development, net	10,609	8,498	1,091	11
Residential development, net	22,513	5,776	11,927	648
Commercial				
Term, net	22,750	8,723	300	8
LOC & other, net	7,144	1,222	1,258	4
Leases, net	—	—	—	—
Residential				
Mortgage, net	—	—	—	—
Home equity loans & lines, net	—	—	—	—
Consumer & other, net	—	—	—	—
Total, net of deferred fees and costs	$126,910	$49,643	$51,140	$1,797

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The following table summarizes our average recorded investment and interest income recognized on impaired non-covered loans by loan class for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30, 2014		Three Months Ended June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial real estate				
Non-owner occupied term, net	$52,913	$297	$—	$—
Owner occupied term, net	12,660	75	—	—
Multifamily, net	2,592	—	79,775	400
Construction & development, net	9,505	195	12,462	150
Residential development, net	14,263	152	20,946	158
Commercial				
Term, net	15,853	4	13,754	5
LOC & other, net	3,055	12	3,455	13
Residential				
Mortgage, net	—	—	383	59
Home equity loans & lines, net	—	—	25	—
Consumer & other, net	—	—	—	—
Total, net of deferred fees and costs	$110,841	$735	$130,800	$785

(in thousands)	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Commercial real estate				
Non-owner occupied term, net	$51,824	$646	$77,846	$769
Owner occupied term, net	12,242	152	—	—
Multifamily, net	2,040	—	—	—
Construction & development, net	9,533	313	15,074	299
Residential development, net	15,410	311	25,276	316
Commercial				
Term, net	13,576	8	13,306	9
LOC & other, net	2,863	25	5,219	24
Residential				
Mortgage, net	—	—	255	114
Home equity loans & lines, net	—	—	159	—
Consumer & other, net	—	—	1	—
Total, net of deferred fees and costs	$107,488	$1,455	$137,136	$1,531

The impaired loans for which these interest income amounts were recognized primarily relate to accruing restructured loans.

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Non-Covered Credit Quality Indicators

As previously noted, the Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The Bank differentiates its lending portfolios into homogeneous loans and leases and non-homogeneous loans and leases. The 10 risk rating categories can be generally described by the following groupings for non-homogeneous loans and leases:

Minimal Risk—A minimal risk loan or lease, risk rated 1, is to a borrower of the highest quality. The borrower has an unquestioned ability to produce consistent profits and service all obligations and can absorb severe market disturbances with little or no difficulty.

Low Risk—A low risk loan or lease, risk rated 2, is similar in characteristics to a minimal risk loan. Margins may be smaller or protective elements may be subject to greater fluctuation. The borrower will have a strong demonstrated ability to produce profits, provide ample debt service coverage and to absorb market disturbances.

Modest Risk—A modest risk loan or lease, risk rated 3, is a desirable loan or lease with excellent sources of repayment and no currently identifiable risk associated with collection. The borrower exhibits a very strong capacity to repay the credit in accordance with the repayment agreement. The borrower may be susceptible to economic cycles, but will have reserves to weather these cycles.

Average Risk—An average risk loan or lease, risk rated 4, is an attractive loan or lease with sound sources of repayment and no material collection or repayment weakness evident. The borrower has an acceptable capacity to pay in accordance with the agreement. The borrower is susceptible to economic cycles and more efficient competition, but should have modest reserves sufficient to survive all but the most severe downturns or major setbacks.

Acceptable Risk—An acceptable risk loan or lease, risk rated 5, is a loan or lease with lower than average, but still acceptable credit risk. These borrowers may have higher leverage, less certain but viable repayment sources, have limited financial reserves and may possess weaknesses that can be adequately mitigated through collateral, structural or credit enhancement. The borrower is susceptible to economic cycles and is less resilient to negative market forces or financial events. Reserves may be insufficient to survive a modest downturn.

Watch—A watch loan or lease, risk rated 6, is still pass-rated, but represents the lowest level of acceptable risk due to an emerging risk element or declining performance trend. Watch ratings are expected to be temporary, with issues resolved or manifested to the extent that a higher or lower rating would be appropriate. The borrower should have a plausible plan, with reasonable certainty of success, to correct the problems in a short period of time.

Special Mention—A special mention loan or lease, risk rated 7, has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or the institution's credit position at some future date. They contain unfavorable characteristics and are generally undesirable. Loans and leases in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of a substandard classification. A special mention loan or lease has potential weaknesses, which if not checked or corrected, weaken the asset or inadequately protect the Bank's position at some future date.

Substandard—A substandard asset, risk rated 8, is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. Loans and leases are classified as

substandard when they have unsatisfactory characteristics causing unacceptable levels of risk. A substandard loan or lease normally has one or more well-defined weaknesses that could jeopardize repayment of the debt. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations is the key distinction between special mention and substandard.

Doubtful—Loans or leases classified as doubtful, risk rated 9, have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a loss (and immediate charge-off) is deferred until more exact status may be determined. Pending factors include proposed merger, acquisition, liquidation procedures, capital injection, and perfection of liens on additional collateral and refinancing plans. In certain circumstances, a doubtful rating will be temporary, while the Bank is awaiting an updated collateral valuation. In these

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cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged-off. The remaining balance, properly margined, may then be upgraded to substandard, however must remain on non-accrual.

Loss—Loans or leases classified as loss, risk rated 10, are considered un-collectible and of such little value that the continuance as an active Bank asset is not warranted. This rating does not mean that the loan or lease has no recovery or salvage value, but rather that the loan or lease should be charged-off now, even though partial or full recovery may be possible in the future.

Impaired—Loans are classified as impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement, without unreasonable delay. This generally includes all loans classified as non-accrual and troubled debt restructurings. Impaired loans are risk rated for internal and regulatory rating purposes, but presented separately for clarification.

Homogeneous loans and leases are not risk rated until they are greater than 30 days past due, and risk rating is based primarily on the past due status of the loan or lease. The risk rating categories can be generally described by the following groupings for commercial and commercial real estate homogeneous loans and leases:

Special Mention—A homogeneous special mention loan or lease, risk rated 7, is 30-59 days past due from the required payment date at month-end.

Substandard—A homogeneous substandard loan or lease, risk rated 8, is 60-89 days past due from the required payment date at month-end.

Doubtful—A homogeneous doubtful loan or lease, risk rated 9, is 90-179 days past due from the required payment date at month-end.

Loss—A homogeneous loss loan or lease, risk rated 10, is 180 days and more past due from the required payment date. These loans are generally charged-off in the month in which the 180 day time period elapses.

The risk rating categories can be generally described by the following groupings for residential and consumer and other homogeneous loans:

Special Mention—A homogeneous retail special mention loan, risk rated 7, is 30-89 days past due from the required payment date at month-end.

Substandard—A homogeneous retail substandard loan, risk rated 8, is an open-end loan 90-180 days past due from the required payment date at month-end or a closed-end loan 90-120 days past due from the required payment date at month-end.

Loss—A homogeneous retail loss loan, risk rated 10, is a closed-end loan that becomes past due 120 cumulative days or an open-end retail loan that becomes past due 180 cumulative days from the contractual due date. These loans are generally charged-off in the month in which the 120 or 180 day period elapses.

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The following table summarizes our internal risk rating by loan and lease class for the non-covered loan and lease portfolio as of June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired (1)	Total
Commercial real estate							
Non-owner occupied term, net	$3,068,321	$114,558	$112,571	$455	$—	$52,124	$3,348,029
Owner occupied term, net	2,495,045	66,195	90,618	2,130	—	12,140	2,666,128
Multifamily, net	2,463,434	7,848	6,883	—	—	4,830	2,482,995
Construction & development, net	243,553	4,892	3,838	—	—	9,484	261,767
Residential development, net	75,108	797	1,687	—	—	14,098	91,690
Commercial							
Term, net	1,048,347	19,866	16,250	301	—	19,442	1,104,206
LOC & other, net	1,263,347	32,938	21,541	509	—	3,832	1,322,167
Leases and equipment finance, net	456,999	1,492	1,395	3,892	6	—	463,784
Residential							
Mortgage, net	1,935,023	6,092	15,789	—	1,693	—	1,958,597
Home equity loans & lines, net	790,689	5,025	2,674	—	783	—	799,171
Consumer & other, net	328,675	2,361	763	—	12	—	331,811
Total, net of deferred fees and costs	$14,168,541	$262,064	$274,009	$7,287	$2,494	$115,950	$14,830,345

(1) Impaired loans includes 5.9% classified as watch, 2.6% classified as special mentioned, 89.4% classified as substandard, and 2.1% classified as doubtful.

(in thousands)	December 31, 2013						
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Impaired (1)	Total
Commercial real estate							
Non-owner occupied term, net	$2,073,366	$108,263	$96,984	$—	$—	$49,647	$2,328,260
Owner occupied term, net	1,182,865	27,615	37,524	173	—	11,406	1,259,583
Multifamily, net	385,335	5,574	11,693	—	—	935	403,537
Construction & development, net	230,262	2,054	3,326	—	—	9,589	245,231
Residential development, net	67,019	1,836	1,855	—	—	17,703	88,413
Commercial							
Term, net	718,778	23,393	19,651	—	—	9,023	770,845
LOC & other, net	951,109	24,197	9,574	—	—	2,480	987,360
Leases and equipment finance, net	351,971	4,585	1,706	2,996	333	—	361,591
Residential							
Mortgage, net	593,723	1,405	743	—	1,330	—	597,201
Home equity loans & lines, net	263,070	1,038	25	—	136	—	264,269
Consumer & other, net	47,895	144	33	—	41	—	48,113
	$6,865,393	$200,104	$183,114	$3,169	$1,840	$100,783	$7,354,403

Total, net of deferred fees and costs

(1) Impaired loans includes 6.4% classified as watch, 3.7% classified as special mentioned, and 89.9% classified as substandard.

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Troubled Debt Restructurings

At June 30, 2014 and December 31, 2013, impaired loans of $67.5 million and $68.8 million, respectively, were classified as accruing restructured loans. The restructurings were granted in response to borrower financial difficulty, and generally provide for a temporary modification of loan repayment terms. The restructured loans on accrual status represent the only impaired loans accruing interest. In order for a restructured loan to be considered for accrual status, the loan's collateral coverage generally will be greater than or equal to 100% of the loan balance, the loan is current on payments, and the borrower must either prefund an interest reserve or demonstrate the ability to make payments from a verified source of cash flow. Impaired restructured loans carry a specific allowance and the allowance on impaired restructured loans is calculated consistently across the portfolios.

There were $3.8 million of available commitments for troubled debt restructurings outstanding as of June 30, 2014 and none as of December 31, 2013.

The following tables present troubled debt restructurings by accrual versus non-accrual status and by loan segment as of June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate, net	$65,612	$3,782	$69,394
Commercial, net	1,245	2,720	3,965
Residential, net	607	—	607
Total, net of deferred fees and costs	$67,464	$6,502	$73,966

(in thousands)	December 31, 2013		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate, net	$67,060	$2,196	$69,256
Commercial, net	1,258	2,603	3,861
Residential, net	473	—	473
Total, net of deferred fees and costs	$68,791	$4,799	$73,590

The Bank's policy is that loans placed on non-accrual will typically remain on non-accrual status until all principal and interest payments are brought current and the prospect for future payment in accordance with the loan agreement appears relatively certain. The Bank's policy generally refers to six months of payment performance as sufficient to warrant a return to accrual status.

The types of modifications offered can generally be described in the following categories:

Rate Modification—A modification in which the interest rate is modified.

Term Modification —A modification in which the maturity date, timing of payments, or frequency of payments is changed.

Interest Only Modification—A modification in which the loan is converted to interest only payments for a period of time.

Payment Modification—A modification in which the payment amount is changed, other than an interest only modification described above.

Combination Modification—Any other type of modification, including the use of multiple types of modifications.

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There were no new non-covered restructured loans during the three months ended March 31, 2014. The following table presents newly non-covered restructured loans that occurred during the three months ended June 30, 2014 and three and six months ended June 30, 2013:

(in thousands)	Three and Six Months Ended June 30, 2014					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate						
Non-owner occupied term, net	$—	$1,244	$—	$—	$—	$1,244
Multifamily, net	—	—	—	—	3,519	3,519
Residential						
Mortgage, net	—	—	—	—	138	138
Total, net of deferred fees and costs	$—	$1,244	$—	$—	$3,657	$4,901

	Three Months Ended June 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Residential						
Mortgage, net	$—	$—	$—	$—	$189	$189
Total, net of deferred fees and costs	$—	$—	$—	$—	$189	$189

(in thousands)	Six Months Ended June 30, 2013					
	Rate Modifications	Term Modifications	Interest Only Modifications	Payment Modifications	Combination Modifications	Total Modifications
Commercial real estate						
Term & multifamily, net	$—	$—	$4,291	$—	$—	$4,291
LOC & other, net	—	—	—	—	452	452
Residential						
Mortgage, net	—	—	—	—	478	478
Total, net of deferred fees and costs	$—	$—	$4,291	$—	$930	$5,221

For the periods presented in the tables above, the outstanding recorded investment was the same pre and post modification.

There were no financing receivables modified as troubled debt restructurings within the previous 12 months for which there was a payment default during the three and six months ended June 30, 2014 and 2013.

Note 6 – Covered Assets and Indemnification Asset

Covered Loans, Net

Loans acquired in an Federal Deposit Insurance Corporation ("FDIC")-assisted acquisition that are subject to a loss-share agreement are referred to as covered loans and reported separately in our statements of financial condition. Covered loans are reported exclusive of the cash flow reimbursements expected from the FDIC.

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The following table presents the major types of covered loans as of June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014	December 31, 2013
Commercial real estate		
Non-owner occupied term, net	$169,299	$206,902
Owner occupied term, net	48,191	49,817
Multifamily, net	23,869	37,671
Construction & development, net	2,383	3,455
Residential development, net	3,167	7,286
Commercial		
Term, net	10,109	15,719
LOC & other, net	8,604	6,698
Residential		
Mortgage, net	18,337	22,316
Home equity loans & lines, net	18,220	19,637
Consumer & other, net	3,931	4,262
Total, net of deferred fees and costs	$306,110	$373,763
Allowance for covered loans	(8,500)	(9,771)
Total	$297,610	$363,992

The outstanding contractual unpaid principal balance, excluding purchase accounting adjustments, at June 30, 2014 was $366.4 million as compared to $462.4 million at December 31, 2013.

In estimating the fair value of the covered loans at the acquisition date, we (a) calculated the contractual amount and timing of undiscounted principal and interest payments and (b) estimated the amount and timing of undiscounted expected principal and interest payments. The difference between these two amounts represents the nonaccretable difference.

On the acquisition date, the amount by which the undiscounted expected cash flows exceed the estimated fair value of the acquired loans is the "accretable yield." The accretable yield is then measured at each financial reporting date and represents the difference between the remaining undiscounted expected cash flows and the current carrying value of the loans.

The following table presents the changes in the accretable yield for the three and six months ended June 30, 2014 and 2013 for the covered loan portfolio:

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$115,574	$169,620	$126,484	$183,388
Accretion to interest income	(15,601)	(14,387)	(27,983)	(28,584)
Disposals	(13,397)	(4,523)	(17,254)	(7,453)
Reclassifications from nonaccretable difference	8,446	4,093	13,775	7,452
Balance, end of period	$95,022	$154,803	$95,022	$154,803

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Allowance for Covered Loan Losses

The following table summarizes activity related to the allowance for covered loan losses by covered loan portfolio segment for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$6,071	$3,469	$632	$148	$10,320
Charge-offs	(700)	(745)	(46)	(27)	(1,518)
Recoveries	238	125	20	18	401
(Recapture) provision	(647)	(10)	(56)	10	(703)
Balance, end of period	$4,962	$2,839	$550	$149	$8,500

	Three Months Ended June 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$12,374	$4,867	$685	$295	$18,221
Charge-offs	(507)	(484)	(58)	(154)	(1,203)
Recoveries	191	108	89	33	421
(Recapture) provision	(3,187)	21	92	2	(3,072)
Balance, end of period	$8,871	$4,512	$808	$176	$14,367

(in thousands)	Six Months Ended June 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$6,105	$2,837	$660	$169	$9,771
Charge-offs	(1,046)	(914)	(164)	(63)	(2,187)
Recoveries	629	246	135	38	1,048
(Recapture) provision	(726)	670	(81)	5	(132)
Balance, end of period	$4,962	$2,839	$550	$149	$8,500

	Six Months Ended June 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Balance, beginning of period	$12,129	$4,980	$804	$362	$18,275
Charge-offs	(768)	(813)	(108)	(332)	(2,021)
Recoveries	487	272	126	68	953
(Recapture) provision	(2,977)	73	(14)	78	(2,840)
Balance, end of period	$8,871	$4,512	$808	$176	$14,367

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The following table presents the allowance and recorded investment in covered loans by portfolio segment as of June 30, 2014 and 2013:

(in thousands)	June 30, 2014				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for covered loans:					
Loans acquired with deteriorated credit quality (1)	$4,880	$2,618	$497	$98	$8,093
Collectively evaluated for impairment (2)	82	221	53	51	407
Total	$4,962	$2,839	$550	$149	$8,500
Covered loans:					
Loans acquired with deteriorated credit quality (1)	$246,377	$9,551	$31,436	$1,454	$288,818
Collectively evaluated for impairment (2)	532	9,162	5,121	2,477	17,292
Total	$246,909	$18,713	$36,557	$3,931	$306,110

(in thousands)	June 30, 2013				
	Commercial Real Estate	Commercial	Residential	Consumer & Other	Total
Allowance for covered loans:					
Loans acquired with deteriorated credit quality (1)	$8,497	$4,124	$758	$130	$13,509
Collectively evaluated for impairment (2)	374	388	50	46	858
Total	$8,871	$4,512	$808	$176	$14,367
Covered loans:					
Loans acquired with deteriorated credit quality (1)	$348,013	$21,935	$41,416	$2,192	$413,556
Collectively evaluated for impairment (2)	2,876	9,475	5,040	2,479	19,870
Total	$350,889	$31,410	$46,456	$4,671	$433,426

(1) The valuation allowance is netted against the carrying value of the covered loan balance.
(2) The allowance on covered loan losses includes an allowance on covered loan advances on acquired loans subsequent to acquisition.

The valuation allowance on covered loans was reduced by recaptured provision of $873,000 and $1.3 million for the three and six months ended June 30, 2014, respectively, and $4.1 million and $5.7 million for the three and six months ended June 30, 2013, respectively.

Covered Credit Quality Indicators

Covered loans are risk rated in a manner consistent with non-covered loans. As previously noted, the Bank's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The 10 risk rating groupings are described fully in Note 5. The following table includes loans acquired with deteriorated credit quality and advances made subsequent to acquisition on covered loans.

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The following table summarizes our internal risk rating grouping by covered loans, net as of June 30, 2014 and December 31, 2013:

(in thousands)	June 30, 2014					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Non-owner occupied term, net	$105,875	$21,468	$39,625	$—	$—	$166,968
Owner occupied term, net	30,342	4,865	11,827	—	—	47,034
Multifamily, net	13,358	1,158	8,893	—	—	23,409
Construction & development, net	1,148	—	824	—	—	1,972
Residential development, net	—	225	2,273	64	—	2,562
Commercial						
Term, net	3,639	505	3,372	—	—	7,516
LOC & other, net	7,618	10	730	—	—	8,358
Residential						
Mortgage, net	18,272	—	—	—	—	18,272
Home equity loans & lines, net	17,655	—	81	—	—	17,736
Consumer & other, net	3,783	—	—	—	—	3,783
Total, net of deferred fees and costs and allowance for loan losses	$201,690	$28,231	$67,625	$64	$—	$297,610

(in thousands)	December 31, 2013					
	Pass/Watch	Special Mention	Substandard	Doubtful	Loss	Total
Commercial real estate						
Non-owner occupied term, net	$133,452	$26,321	$44,279	$—	$—	$204,052
Owner occupied term, net	30,119	3,370	14,971	213	—	48,673
Multifamily, net	24,213	2,563	10,409	—	—	37,185
Construction & development, net	1,117	—	1,686	—	—	2,803
Residential development, net	492	224	5,541	54	—	6,311
Commercial						
Term, net	3,753	3,141	6,128	258	—	13,280
LOC & other, net	4,630	991	681	—	—	6,302
Residential						
Mortgage, net	22,175	—	—	—	—	22,175
Home equity loans & lines, net	19,043	—	76	—	—	19,119
Consumer & other, net	4,092	—	—	—	—	4,092
Total, net of deferred fees and costs and allowance for loan losses	$243,086	$36,610	$83,771	$525	$—	$363,992

FDIC Indemnification Asset

The Company has elected to account for amounts receivable under the loss-share agreements as an indemnification asset. The FDIC indemnification asset is initially recorded at fair value, based on the discounted value of expected future cash flows under the loss-share agreement. The difference between the present value and the undiscounted cash flows the Company expects to collect from the FDIC will be accreted into non-interest income over the life of the

FDIC indemnification asset.

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Subsequent to initial recognition, the FDIC indemnification asset is reviewed quarterly and adjusted for any changes in expected cash flows based on recent performance and expectations for future performance of the covered assets. These adjustments are measured on the same basis as the related covered loans and covered OREO. Any increases in cash flow of the covered assets over those expected will reduce the FDIC indemnification asset and any decreases in cash flow of the covered assets under those expected will increase the FDIC indemnification asset. Increases and decreases to the FDIC indemnification asset are recorded as adjustments to non-interest income. The resulting carrying value of the indemnification asset represents the amounts recoverable from the FDIC for future expected losses, and the amounts due from the FDIC for claims related to covered losses the Company has incurred less amounts due back to the FDIC relating to shared recoveries.

The following table summarizes the activity related to the FDIC indemnification asset for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$18,362	$46,046	$23,174	$52,798
Change in FDIC indemnification asset	(5,601)	(8,294)	(10,441)	(13,367)
Transfers to due from FDIC and other	(1,468)	(1,489)	(1,440)	(3,168)
Balance, end of period	$11,293	$36,263	$11,293	$36,263

Note 7–Goodwill and Other Intangible Assets

The following tables summarize the changes in the Company's goodwill and other intangible assets for the year ended December 31, 2013, and the six months ended June 30, 2014. Goodwill and all other intangible assets are related to the Community Banking segment.

(in thousands)	Goodwill		
	Gross	Accumulated Impairment	Total
Balance, December 31, 2012	$781,106	$(112,934)	$668,172
Net additions	96,777	—	96,777
Reductions	(644)	—	(644)
Balance, December 31, 2013	877,239	(112,934)	764,305
Net additions	1,015,427	—	1,015,427
Reductions	—	—	—
Balance, June 30, 2014	$1,892,666	$(112,934)	$1,779,732

Goodwill represents the excess of the total purchase price paid over the fair value of the assets acquired, net of the fair values of liabilities assumed. Additional information on the acquisitions and purchase price allocations is provided in Note 2. The reduction to goodwill in 2013 of $644,000 relates to purchase accounting adjustments.

(in thousands)	Other Intangible Assets		
	Gross	Accumulated Amortization	Net
Balance, December 31, 2012	$58,909	(41,750)	$17,159
Net additions	—	—	—
Amortization	—	(4,781)	(4,781)
Balance, December 31, 2013	58,909	(46,531)	12,378
Net additions	54,562	—	54,562

Amortization	—	(4,002)	(4,002)
Balance, June 30, 2014	$113,471	$(50,533)	$62,938

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Intangible additions in 2014 relate to the Bank Merger and represent the value of the core deposits, which includes all deposits except certificates of deposit. The value of the core deposit intangible assets were determined by an analysis of the cost differential between the core deposits inclusive of estimated servicing costs and alternative funding sources. The core deposit intangible recorded in connection with the Merger will be amortized on an accelerated basis over a period of 10 years.

The Company conducts its annual evaluation of goodwill for impairment as of its year end of December 31. Goodwill and other intangibles are required to be analyzed for impairment if certain triggering events occurred. During the six months ended June 30, 2014, management determined that no trigger events occurred that required an impairment analysis. The table below presents the forecasted amortization expense for intangible assets acquired in all mergers:

(in thousands)	
Year	Expected Amortization
Remainder of 2014	$6,205
2015	11,225
2016	8,622
2017	6,756
2018	6,166
Thereafter	23,964
	$62,938

Note 8 – Residential Mortgage Servicing Rights

The following table presents the changes in the Company's residential rights ("MSR") for the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$49,220	$32,097	$47,765	$27,428
Acquired/purchased MSR	62,770	—	62,770	—
Additions for new MSR capitalized	5,362	4,708	7,770	11,110
Changes in fair value:				
Due to changes in model inputs or assumptions(1)	(784)	1,858	(1,871)	333
Other(2)	(2,376)	(471)	(2,242)	(679)
Balance, end of period	$114,192	$38,192	$114,192	$38,192

(1) Principally reflects changes in discount rates and prepayment speed assumptions, which are primarily affected by changes in interest rates.
(2) Represents changes due to collection/realization of expected cash flows over time.

Information related to our residential mortgage serviced loan portfolio as of June 30, 2014 and December 31, 2013 is as follows:

(dollars in thousands)	June 30, 2014	December 31, 2013
Balance of residential mortgage loans serviced for others	$10,838,313	$4,362,499
MSR as a percentage of serviced loans	1.05%	1.09%

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The amount of contractually specified servicing fees, late fees and ancillary fees earned, recorded in residential mortgage banking revenue, was $5.4 million and $8.3 million for the three and six months ended June 30, 2014, as compared to $2.5 million and $4.8 million for the three and six months ended June 30, 2013.

Key assumptions used in measuring the fair value of MSR as of June 30, 2014 and December 31, 2013 are as follows:

	June 30, 2014	December 31, 2013
Constant prepayment rate	11.58 %	12.74 %
Discount rate	9.14 %	8.69 %
Weighted average life (years)	6.6	6.0

A sensitivity analysis of the current fair value to changes in discount and prepayment speed assumptions as of June 30, 2014 and December 31, 2013 is as follows:

(in thousands)	June 30, 2014	December 31, 2013
Constant prepayment rate		
Effect on fair value of a 10% adverse change	$(4,610)	$(2,255)
Effect on fair value of a 20% adverse change	$(8,863)	$(4,323)
Discount rate		
Effect on fair value of a 100 basis point adverse change	$(4,380)	$(1,832)
Effect on fair value of a 200 basis point adverse change	$(8,440)	$(3,534)

The sensitivity analysis presents the hypothetical effect on fair value of the MSR. The effect of such hypothetical change in assumptions generally cannot be extrapolated because the relationship of the change in an assumption to the change in fair value is not linear. Additionally, in the analysis, the impact of an adverse change in one assumption is calculated independent of any impact on other assumptions. In reality, changes in one assumption may change another assumption.

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Note 9 – Junior Subordinated Debentures

Following is information about the Company's wholly-owned trusts ("Trusts") as of June 30, 2014:

(dollars in thousands) Trust Name	Issue Date	Issued Amount	Carrying Value (1)	Rate (2)	Effective Rate (3)	Maturity Date
AT FAIR VALUE:						
Umpqua Statutory Trust II	October 2002	$20,619	$14,946	Floating rate, LIBOR plus 3.35%, adjusted quarterly	4.93%	October 2032
Umpqua Statutory Trust III	October 2002	30,928	22,619	Floating rate, LIBOR plus 3.45%, adjusted quarterly	5.02%	November 2032
Umpqua Statutory Trust IV	December 2003	10,310	7,061	Floating rate, LIBOR plus 2.85%, adjusted quarterly	4.49%	January 2034
Umpqua Statutory Trust V	December 2003	10,310	7,039	Floating rate, LIBOR plus 2.85%, adjusted quarterly	4.51%	March 2034
Umpqua Master Trust I	August 2007	41,238	23,082	Floating rate, LIBOR plus 1.35%, adjusted quarterly	2.82%	September 2037
Umpqua Master Trust IB	September 2007	20,619	13,607	Floating rate, LIBOR plus 2.75%, adjusted quarterly	4.52%	December 2037
Sterling Capital Trust III	April 2003	14,433	11,026	Floating rate, LIBOR plus 3.25%, adjusted quarterly	4.55%	April 2033
Sterling Capital Trust IV	May 2003	10,310	7,788	Floating rate, LIBOR plus 3.15%, adjusted quarterly	4.47%	May 2033
Sterling Capital Statutory Trust V	May 2003	20,619	15,642	Floating rate, LIBOR plus 3.25%, adjusted quarterly	4.59%	June 2033
Sterling Capital Trust VI	June 2003	10,310	7,766	Floating rate, LIBOR plus 3.20%, adjusted quarterly	4.55%	September 2033
Sterling Capital Trust VII	June 2006	56,702	32,894	Floating rate, LIBOR plus 1.53%, adjusted quarterly	3.03%	June 2036
Sterling Capital Trust VIII	September 2006	51,547	30,270	Floating rate, LIBOR plus 1.63%, adjusted quarterly	3.17%	December 2036
Sterling Capital Trust IX	July 2007	46,392	26,110	Floating rate, LIBOR plus 1.40%, adjusted quarterly	2.90%	October 2037
Lynnwood Financial Statutory Trust I	March 2003	9,279	6,956	Floating rate, LIBOR plus 3.15%, adjusted quarterly	4.51%	March 2033
	June 2005	10,310	6,309		3.32%	June 2035

Lynnwood Financial Statutory Trust II				Floating rate, LIBOR plus 1.80%, adjusted quarterly		
Klamath First Capital Trust I	July 2001	15,464	12,962	Floating rate, LIBOR plus 3.75%, adjusted semiannually	4.88%	July 2031
		$379,390	$246,077			
AT AMORTIZED COST:						
HB Capital Trust I	March 2000	$5,310	$6,189	10.875%	8.43%	March 2030
Humboldt Bancorp Statutory Trust I	February 2001	5,155	5,800	10.200%	8.39%	February 2031
Humboldt Bancorp Statutory Trust II	December 2001	10,310	11,244	Floating rate, LIBOR plus 3.60%, adjusted quarterly	3.03%	December 2031
Humboldt Bancorp Statutory Trust III	September 2003	27,836	30,278	Floating rate, LIBOR plus 2.95%, adjusted quarterly	2.50%	September 2033
CIB Capital Trust	November 2002	10,310	11,110	Floating rate, LIBOR plus 3.45%, adjusted quarterly	3.01%	November 2032
Western Sierra Statutory Trust I	July 2001	6,186	6,186	Floating rate, LIBOR plus 3.58%, adjusted quarterly	3.80%	July 2031
Western Sierra Statutory Trust II	December 2001	10,310	10,310	Floating rate, LIBOR plus 3.60%, adjusted quarterly	3.83%	December 2031
Western Sierra Statutory Trust III	September 2003	10,310	10,310	Floating rate, LIBOR plus 2.90%, adjusted quarterly	3.13%	September 2033
Western Sierra Statutory Trust IV	September 2003	10,310	10,310	Floating rate, LIBOR plus 2.90%, adjusted quarterly	3.13%	September 2033
		96,037	101,737			
	Total	$475,427	$347,814			

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(1) Includes purchase accounting adjustments, net of accumulated amortization, for junior subordinated debentures assumed in connection with previous mergers as well as fair value adjustments related to trusts recorded at fair value.
(2) Contractual interest rate of junior subordinated debentures.
(3) Effective interest rate based upon the carrying value as of June 30, 2014.

The Trusts are reflected as junior subordinated debentures in the Condensed Consolidated Balance Sheets. The common stock issued by the Trusts is recorded in other assets in the Condensed Consolidated Balance Sheets, and totaled $14.3 million at June 30, 2014 and $6.9 million at December 31, 2013. As of June 30, 2014, all of the junior subordinated debentures were redeemable at par, at their applicable quarterly or semiannual interest payment dates.

The Company selected the fair value measurement option for junior subordinated debentures originally issued by the Company (the Umpqua Statutory Trusts) and for junior subordinated debentures acquired from Sterling. Refer to Note 16 for discussion of the rational for election of fair value and the approach used to fair value the selected junior subordinated debentures.

Absent changes to the significant inputs utilized in the discounted cash flow model used to measure the fair value of these instruments, the discounts will reverse over time in a manner similar to the effective interest rate method as if these instruments were accounted for under the amortized cost method. Losses recorded resulting from the change in the fair value of these instruments were $1.4 million and $547,000 for the three months ended June 30, 2014 and 2013 and $1.9 million and $1.1 million for the six months ended June 30, 2014 and 2013.

Note 10 – Commitments and Contingencies

Lease Commitments — As of June 30, 2014, the Bank leased 294 sites under non-cancelable operating leases. The leases contain various provisions for increases in rental rates, based either on changes in the published Consumer Price Index or a predetermined escalation schedule. Substantially all of the leases provide the Company with the option to extend the lease term one or more times following expiration of the initial term.

Rent expense for the three and six months ended June 30, 2014 was $8.8 million and $13.8 million and for the three and six months ended June 30, 2013 was $4.7 million and $9.3 million. Rent expense was partially offset by rent income for the three and six months ended June 30, 2014 of $94,000 and $271,000 and for the three and six months ended June 30, 2013 of $192,000 and $448,000.

Financial Instruments with Off-Balance-Sheet Risk — The Company's financial statements do not reflect various commitments and contingent liabilities that arise in the normal course of the Bank's business and involve elements of credit, liquidity, and interest rate risk.

The following table presents a summary of the Bank's commitments and contingent liabilities:

(in thousands)	As of June 30, 2014
Commitments to extend credit	$2,753,348
Forward sales commitments	$482,000
Commitments to originate residential mortgage loans held for sale	$323,047
Standby letters of credit	$64,244

The Bank is a party to financial instruments with off-balance-sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby

letters of credit and financial guarantees. Those instruments involve elements of credit and interest-rate risk similar to the risk involved in on-balance sheet items recognized in the Condensed Consolidated Balance Sheets. The contract or notional amounts of those instruments reflect the extent of the Bank's involvement in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit, and financial guarantees written, is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any covenant or condition established in the applicable contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. While most standby letters of credit are not utilized, a significant portion of such utilization is on an immediate payment basis. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral varies but may include cash, accounts receivable, inventory, premises and equipment and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including international trade finance, commercial paper, bond financing and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary. The Bank was not required to perform on any financial guarantees and there were no recoveries during the three and six months ended June 30, 2014. The Bank was not required to perform on any financial guarantees and incurred none and $79,000 losses in connection with standby letters of credit during the three and six months ended June 30, 2013. At June 30, 2014, approximately $42.0 million of standby letters of credit expire within one year, and $22.3 million expire thereafter. Upon issuance, the Bank recognizes a liability equivalent to the amount of fees received from the customer for these standby letter of credit commitments. Fees are recognized ratably over the term of the standby letter of credit. The estimated fair value of guarantees associated with standby letters of credit was $1.5 million as of June 30, 2014.

Residential mortgage loans sold into the secondary market are sold with limited recourse against the Company, meaning that the Company may be obligated to repurchase or otherwise reimburse the investor for incurred losses on any loans that suffer an early payment default, are not underwritten in accordance with investor guidelines or are determined to have pre-closing borrower misrepresentations. As of June 30, 2014, the Company had a residential mortgage loan repurchase reserve liability of $3.5 million.

Legal Proceedings—The Bank owns 483,806 shares of Class B common stock of Visa Inc. which are convertible into Class A common stock at a conversion ratio of 0.4206 per Class A share. As of June 30, 2014, the value of the Class A shares was $210.71 per share. Utilizing the conversion ratio, the value of unredeemed Class A equivalent shares owned by the Bank was $42.9 million as of June 30, 2014, and has not been reflected in the accompanying financial statements. The shares of Visa Inc. Class B common stock are restricted and may not be transferred. Visa member banks are required to fund an escrow account to cover settlements, resolution of pending litigation and related claims. If the funds in the escrow account are insufficient to settle all the covered litigation, Visa Inc. may sell additional Class A shares and use the proceeds to settle litigation, thereby reducing the conversion ratio. If funds remain in the escrow account after all litigation is settled, the Class B conversion ratio will be increased to reflect that surplus.

On July 13, 2012, Visa Inc. announced that it had entered into a memorandum of understanding obligating it to enter into a settlement agreement to resolve the multi-district interchange litigation brought by the class plaintiffs in the matter styled In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, Case No. 5-MD-1720 (JG) (JO) pending in the U.S. District Court for the Eastern District of New York. The claims originally were brought by a class of U.S. retailers in 2005. The settlement was approved by the court on December 13, 2013, but that decision is currently being appealed. Visa's share of the previously agreed settlement amount was approximately $4.4 billion. The effect of this proposed settlement and pending appeal on the value of the Bank's Class B common stock is unknown at this time.

In the ordinary course of business, various claims and lawsuits are brought by and against the Company and its subsidiaries, including the Bank and Umpqua Investments. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the Company's consolidated financial condition or results of operations.

Concentrations of Credit Risk— The Bank grants real estate mortgage, real estate construction, commercial, agricultural and installment loans and leases to customers throughout Oregon, Washington, California, Idaho, and Nevada. In management's judgment, a concentration exists in real estate-related loans, which represented approximately 80% and 74% of the Bank's non-covered loan and lease portfolio at June 30, 2014 and December 31, 2013, respectively. Commercial real estate concentrations are managed to assure wide geographic and business diversity. Although management believes such concentrations have no more than the normal risk of collectability, a substantial decline in the economy in general, material increases in interest rates, changes in tax policies, tightening credit or refinancing markets, or a decline in real estate values in the Bank's primary market areas in particular, could have an adverse impact on the repayment of these loans. Personal and business incomes, proceeds

from the sale of real property, or proceeds from refinancing, represent the primary sources of repayment for a majority of these loans.

The Bank recognizes the credit risks inherent in dealing with other depository institutions. Accordingly, to prevent excessive exposure to any single correspondent, the Bank has established general standards for selecting correspondent banks as well as internal limits for allowable exposure to any single correspondent. In addition, the Bank has an investment policy that sets forth limitations that apply to all investments with respect to credit rating and concentrations with an issuer.

Note 11 – Derivatives

The Bank may use derivatives to hedge the risk of changes in the fair values of interest rate lock commitments, residential mortgage loans held for sale, and residential mortgage servicing rights. None of the Company's derivatives are designated as hedging instruments. Rather, they are accounted for as free-standing derivatives, or economic hedges, with changes in the fair value of the derivatives reported in income. The Company primarily utilizes forward interest rate contracts in its derivative risk management strategy.

The Bank enters into forward delivery contracts to sell residential mortgage loans or mortgage-backed securities to broker/dealers at specific prices and dates in order to hedge the interest rate risk in its portfolio of mortgage loans held for sale and its residential mortgage loan commitments. Credit risk associated with forward contracts is limited to the replacement cost of those forward contracts in a gain position. There were no counterparty default losses on forward contracts in the three and six months ended June 30, 2014 and 2013. Market risk with respect to forward contracts arises principally from changes in the value of contractual positions due to changes in interest rates. The Bank limits its exposure to market risk by monitoring differences between commitments to customers and forward contracts with broker/dealers. In the event the Company has forward delivery contract commitments in excess of available mortgage loans, the Company completes the transaction by either paying or receiving a fee to or from the broker/dealer equal to the increase or decrease in the market value of the forward contract. At June 30, 2014, the Bank had commitments to originate mortgage loans held for sale totaling $323.0 million and forward sales commitments of $482.0 million.

The Bank's mortgage banking derivative instruments do not have specific credit risk-related contingent features. The forward sales commitments do have contingent features that may require transferring collateral to the broker/dealers upon their request. However, this amount would be limited to the net unsecured loss exposure at such point in time and would not materially affect the Company's liquidity or results of operations.

The Bank executes interest rate swaps with commercial banking customers to facilitate their respective risk management strategies. Those interest rate swaps are simultaneously hedged by offsetting the interest rate swaps that the Bank executes with a third party, such that the Bank minimizes its net risk exposure. As of June 30, 2014, the Bank had 296 interest rate swaps with an aggregate notional amount of $1.5 billion related to this program.

In connection with the interest rate swap program with commercial customers, the Bank has agreements with its derivative counterparties that contain a provision where if the Bank defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Bank could also be declared in default on its derivative obligations. The Bank also has agreements with its derivative counterparties that contain a provision where if the Bank fails to maintain its status as a well/adequately capitalized institution, then the counterparty could terminate the derivative positions and the Bank would be required to settle its obligations under the agreements. Similarly, the Bank could be required to settle its obligations under certain of its agreements if specific regulatory events occur, such as if the Bank were issued a prompt corrective action directive or a cease and desist order, or if certain regulatory ratios fall below specified levels. If the Bank had breached any of these provisions at June 30, 2014, it could have been required to settle its obligations under the agreements at the

termination value.

As of June 30, 2014, the termination value of derivatives in a net liability position, which includes accrued interest but excludes any adjustment for nonperformance risk, related to these agreements was $21.6 million. The Bank has collateral posting requirements for initial or variation margins with its clearing members and clearing houses and has been required to post collateral against its obligations under these agreements of $33.2 million and $13.0 million as of June 30, 2014 and December 31, 2013, respectively.

The Bank incorporates credit valuation adjustments ("CVA") to appropriately reflect nonperformance risk in the fair value measurement of its derivatives. As of June 30, 2014, the net CVA decreased the settlement values of the Bank's net derivative assets by $1.5 million. During the three and six months ended June 30, 2014, the Bank recognized a loss of $1.8 million and $3.0 million, respectively, and during the three and six months ended June 30, 2013, the Bank recognized a gain of $1.8 million

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for both periods related to CVA on nonhedge derivative instruments, which is included in noninterest income. Various factors impact changes in the CVA over time, including changes in the credit spreads of the parties to the contracts, as well as changes in market rates and volatilities, which affect the total expected exposure of the derivative instruments.

The following tables summarize the types of derivatives, separately by assets and liabilities, and the fair values of such derivatives as of June 30, 2014 and December 31, 2013:

(in thousands)	Asset Derivatives		Liability Derivatives	
Derivatives not designated	June 30,	December 31,	June 30,	December 31,
as hedging instrument	2014	2013	2014	2013
Interest rate lock commitments	$4,580	$706	$175	$—
Interest rate forward sales commitments	21	1,250	4,700	6
Interest rate swaps	19,609	15,965	21,029	14,556
Total	$24,210	$17,921	$25,904	$14,562

The fair values of the derivatives are recorded in other assets and other liabilities. The following table summarizes the types of derivatives and the gains (losses) recorded during the three and six months ended June 30, 2014 and 2013:

(in thousands)	Three months ended		Six Months Ended	
Derivatives not designated	June 30,		June 30,	
as hedging instrument	2014	2013	2014	2013
Interest rate lock commitments	$6,099	$(3,307)	$6,787	$(840)
Interest rate forward sales commitments	(13,368)	12,116	(16,016)	14,748
Interest rate swaps	(1,787)	1,823	(3,001)	1,839
Total	$(9,056)	$10,632	$(12,230)	$15,747

The gains and losses on the Company's mortgage banking derivatives are included in mortgage banking revenue. The gains and losses on the Company's interest rate swaps are included in other income.

The following table summarizes the offsetting derivatives assets that have a right of offset as of June 30, 2014 and December 31, 2013:

(in thousands)				Gross Amounts Not Offset in the Statement of Financial Position		
	Gross Amounts of Recognized Assets/Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets/Liabilities presented in the Statement of Financial Position	Financial Instruments	Collateral Posted	Net Amount
June 30, 2014						
Derivative Assets						
Interest rate swaps	$ 19,609	$—	$ 19,609	$(1,689)	$(18,309)	$(389)
Derivative Liabilities						
Interest rate swaps	$ 21,029	$—	$ 21,029	$(1,689)	$(19,340)	$—

December 31, 2013						
Derivative Assets						
Interest rate swaps	$ 15,965	$—	$ 15,965	$(4,852)	$(2,207)	$8,906
Derivative Liabilities						
Interest rate swaps	$ 14,556	$—	$ 14,556	$(4,852)	$(9,704)	$—

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Note 12 – Shareholders' Equity and Stock Compensation

On April 18, 2014, the Company completed the Merger with Sterling. The details of the conversion of Sterling common stock, stock options, and restricted stock units are included in Note 2. The conversion resulted in the issuance of 104,385,087 shares of common stock, 994,214 restricted stock units, and 439,921 stock options granted. Additionally, the 2,960,238 outstanding Sterling warrants were converted into warrants exercisable to receive 1.671 shares of Umpqua stock per warrant, with an exercise price of $12.88 as of the merger date. As of June 30, 2014, there were 2,995,130 warrants outstanding, with an exercise price of $12.73. Adjustments to the number and exercise price of these outstanding warrants occurred in the second quarter of 2014, due to dividend distributions triggering an anti-dilutive provision.

At a special meeting on February 25, 2014, the Company's shareholders approved an amendment to the Company's articles of incorporation, effective on April 18, 2014, increasing the number of authorized shares of common stock to 400,000,000.

At the annual meeting on April 16, 2013, shareholders approved the Company's 2013 Incentive Plan (the "2013 Plan"), which, among other things, authorizes the issuance of equity awards to directors and employees and reserves 4,000,000 shares of the Company's common stock for issuance under the plan. With the adoption of the 2013 Plan, no additional awards will be issued from the 2003 Stock Incentive Plan or the 2007 Long Term Incentive Plan.

Stock-Based Compensation

The compensation cost related to stock options, restricted stock and restricted stock units (included in salaries and employee benefits) was $3.6 million and $5.1 million for the three and six months ended June 30, 2014, as compared to $1.0 million and $2.2 million for the three and six months ended June 30, 2013. The total income tax benefit recognized related to stock-based compensation was $1.4 million and $2.0 million for the three and six months ended June 30, 2014 as compared to $415,000 and $889,000 for the three and six months ended June 30, 2013. During the three months ended June 30, 2014, vesting was accelerated for certain restricted stock units and stock options issued in connection with the merger with Sterling, resulting in $3.6 million of accelerated compensation expense which was recorded in merger expense.

The following table summarizes information about stock option activity for the six months ended June 30, 2014:

(in thousands, except per share data)	Six Months Ended June 30, 2014				
	Options Outstanding		Weighted-Avg Exercise Price	Weighted-Avg Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance, beginning of period	981		$16.17		
Granted/Assumed	440		$12.12		
Exercised	(522	)	$11.92		
Forfeited/expired	(35	)	$18.90		
Balance, end of period	864		$16.56	4.08	$3,217
Options exercisable, end of period	697		$17.60	3.20	$2,268

The total intrinsic value (which is the amount by which the stock price exceeded the exercise price on the date of exercise) of options exercised during the three and six months ended June 30, 2014 was $1.4 million and $2.8 million, as compared to the three and six months ended June 30, 2013 of $130,000 and $137,000.

During the three and six months ended June 30, 2014, the amount of cash received from the exercise of stock options was $3.4 million and $4.3 million, as compared to the three and six months ended June 30, 2013 of $29,000 and $52,000. Total consideration was $3.6 million and $6.2 million for the three and six months ended June 30, 2014, as compared to the three and six months ended June 30, 2013 of $813,000 and $846,000.

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The fair value of each option grant is estimated as of the grant date using the Black-Scholes option-pricing model. There were no stock options granted in the six months ended June 30, 2013. The following weighted average assumptions were used to determine the fair value of stock options grants as of grant date for the six months ended June 30, 2014:

	Six Months Ended June 30, 2014	
Dividend yield	3.25	%
Expected life (years)	6.79	
Expected volatility	31	%
Risk-free rate	0.91	%
Weighted average fair value of options on date of grant	$3.22	

The Company grants restricted stock periodically for the benefit of employees and directors. Restricted shares issued prior to 2011 generally vest on an annual basis over five years. Restricted shares issued since 2011 generally vest over a three year period, subject to time or time plus performance vesting conditions. The following table summarizes information about nonvested restricted share activity for the six months ended June 30, 2014:

(in thousands, except per share data)	Six Months Ended June 30, 2014		
	Restricted Shares Outstanding		Weighted Average Grant Date Fair Value
Balance, beginning of period	992		$12.79
Granted/Assumed	836		$17.34
Released	(362	)	$12.21
Forfeited/expired	(13	)	$13.17
Balance, end of period	1,453		$15.54

The total fair value of restricted shares vested and released during the three and six months ended June 30, 2014 was $878,000 and $6.4 million as compared to the three and six months ended June 30, 2013 of $514,000 and $1.8 million.

The Company granted restricted stock units as a part of the 2007 Long Term Incentive Plan for the benefit of certain executive officers. In addition, the Company granted restricted stock units in connection with the acquisition of Sterling as replacement awards. Restricted stock unit grants may be subject to performance-based vesting as well as other approved vesting conditions. The total number of restricted stock units granted represents the maximum number of restricted stock units eligible to vest based upon the performance and service conditions set forth in the grant agreements.

(in thousands, except per share data)	Six Months Ended June 30, 2014		
	Restricted Stock Units Outstanding		Weighted Average Grant Date Fair Value
Balance, beginning of period	95		$10.41
Granted/Assumed	1,024		$18.34
Released	(320	)	$16.58
Forfeited/expired	(29	)	$18.58
Balance, end of period	770		$18.36

As of June 30, 2014, there was $568,000 of total unrecognized compensation cost related to nonvested stock options which is expected to be recognized over a weighted-average period of 1.95 years. As of June 30, 2014, there was $14.5 million of total unrecognized compensation cost related to nonvested restricted stock which is expected to be recognized over a weighted-average period of 1.73 years. As of June 30, 2014, there was $12.0 million of total unrecognized compensation cost related to

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nonvested restricted stock units which is expected to be recognized over a weighted-average period of 2.74 years, assuming expected performance conditions are met.

For the three and six months ended June 30, 2014, the Company received income tax benefits of $2.5 million and $5.7 million, respectively, as compared to the three and six months ended June 30, 2013 of $257,000 and $775,000, respectively, related to the exercise of non-qualified employee stock options, disqualifying dispositions on the exercise of incentive stock options, the vesting of restricted shares and the vesting of restricted stock units. In the six months ended June 30, 2014, the Company had net excess tax benefit (tax benefit resulting from tax deductions greater than the compensation cost recognized) of $1.2 million, compared to $33,000 of net tax deficiencies (tax deficiency resulting from tax deductions greater than the compensation cost recognized) for the six months ended June 30, 2013. Only gross excess tax benefits are classified as financing cash flows.

Note 13 – Income Taxes

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, as well as in the majority of states and in Canada. The Company acquired a $276.8 million net deferred tax asset before purchase accounting adjustments in the Merger, including $238.4 million of federal and state net operating loss ("NOL") and tax credit carry-forwards. The Merger triggered an "ownership change" as defined in Section 382 of the Internal Revenue Service Code ("Section 382"). As a result of being subject to Section 382, the Company will be limited in the amount of federal NOL carry-forwards that can be used annually to offset future taxable income. The Company believes it is more likely than not that it will be able to fully realize the benefit of its federal NOL carry-forwards. The Company also believes that it is more likely than not that the benefit from certain state NOL carry-forwards will not be realized and therefore has provided a valuation allowance of $3.3 million against the deferred tax assets relating to these state NOL carry-forwards.

The Company had gross unrecognized tax benefits of $995,000 recorded as of June 30, 2014, including $446,000 assumed in the Merger. If recognized, the unrecognized tax benefit would reduce the 2014 annual effective tax rate by 0.3%. During the three months and six months ended June 30, 2014, the Company accrued $5,000 and $1,000, respectively, of interest relating to its liability for unrecognized tax benefits. Interest on unrecognized tax benefits is reported by the Company as a component of tax expense. As of June 30, 2014, the accrued interest related to unrecognized tax benefits was $278,000, including $84,000 assumed in the Merger.

Note 14 – Earnings Per Common Share

Nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of earnings per share pursuant to the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Certain of the Company's nonvested restricted stock awards qualify as participating securities.

Net earnings is allocated between the common stock and participating securities pursuant to the two-class method. Basic earnings per common share is computed by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

Diluted earnings per common share is computed in a similar manner, except that first the denominator is increased to include the number of additional common shares that would have been outstanding if potentially dilutive common shares, excluding the participating securities, were issued using the treasury stock method. For all periods presented, stock options, certain restricted stock awards and restricted stock units are the only potentially dilutive

non-participating instruments issued by the Company. Next, we determine and include in diluted earnings per common share calculation the more dilutive effect of the participating securities using the treasury stock method or the two-class method. Undistributed losses are not allocated to the nonvested share-based payment awards (the participating securities) under the two-class method as the holders are not contractually obligated to share in the losses of the Company.

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The following is a computation of basic and diluted earnings per common share for the three and six months ended June 30, 2014 and 2013:

(in thousands, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
NUMERATORS:				
Net income	$17,221	$26,253	$35,985	$49,614
Less:				
Dividends and undistributed earnings allocated to participating securities (1)	83	197	196	380
Net earnings available to common shareholders	$17,138	$26,056	$35,789	$49,234
DENOMINATORS:				
Weighted average number of common shares outstanding - basic	196,312	111,954	154,473	111,946
Effect of potentially dilutive common shares (2)	1,326	191	803	187
Weighted average number of common shares outstanding - diluted	197,638	112,145	155,276	112,133
EARNINGS PER COMMON SHARE:				
Basic	$0.09	$0.23	$0.23	$0.44
Diluted	$0.09	$0.23	$0.23	$0.44

(1) Represents dividends paid and undistributed earnings allocated to nonvested restricted stock awards.

(2) Represents the effect of the assumed exercise of stock options, vesting of non-participating restricted shares, and vesting of restricted stock units and warrants that were converted into warrants exercisable for Umpqua common shares in connection with the Sterling acquisition, based on the treasury stock method.

The following table presents the weighted average outstanding securities that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive for the three and six months ended June 30, 2014 and 2013.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Stock options	519	863	273	933

Note 15 – Segment Information

The Company operates two primary segments: Community Banking and Home Lending. The Community Banking segment's principal business focus is the offering of loan and deposit products to business and retail customers in its primary market areas. As of June 30, 2014, the Community Banking segment operated 422 locations throughout Oregon, Washington, California, Idaho, and Nevada.

The Home Lending segment, which operates as a division of the Bank, originates, sells and services residential mortgage loans.

In the second quarter of 2014, the Company combined its Wealth Management segment into the Community Banking segment as Wealth Management no longer met the definition of an operating segment. The segment results for comparable periods have been modified to reflect the current period presentation.

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Summarized financial information concerning the Company's reportable segments and the reconciliation to the consolidated financial results is shown in the following tables:

(in thousands)	Three Months Ended June 30, 2014		
	Community Banking	Home Lending	Consolidated
Interest income	$207,497	$17,470	$224,967
Interest expense	11,365	1,343	12,708
Net interest income	196,132	16,127	212,259
Provision for non-covered loan and lease losses	15,399	—	15,399
(Recapture of) provision for covered loan losses	(703)	—	(703)
Non-interest income	19,978	24,551	44,529
Non-interest expense	195,296	18,835	214,131
Income before income taxes	6,118	21,843	27,961
Provision for income taxes	2,003	8,737	10,740
Net income	4,115	13,106	17,221
Dividends and undistributed earnings allocated to participating securities	83	—	83
Net earnings available to common shareholders	$4,032	$13,106	$17,138

	Six Months Ended June 30, 2014		
	Community Banking	Home Lending	Consolidated
Interest income	$317,654	$23,193	$340,847
Interest expense	18,855	1,895	20,750
Net interest income	298,799	21,298	320,097
Provision for non-covered loan and lease losses	20,799	—	20,799
(Recapture of) provision for covered loan losses	(132)	—	(132)
Non-interest income	32,465	35,071	67,536
Non-interest expense	284,630	26,019	310,649
Income before income taxes	25,967	30,350	56,317
Provision for income taxes	8,192	12,140	20,332
Net income	17,775	18,210	35,985
Dividends and undistributed earnings allocated to participating securities	196	—	196
Net earnings available to common shareholders	$17,579	$18,210	$35,789

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(in thousands)	Three Months Ended June 30, 2013		
	Community Banking	Home Lending	Consolidated
Interest income	$98,571	$5,444	$104,015
Interest expense	9,463	659	10,122
Net interest income	89,108	4,785	93,893
Provision for non-covered loan and lease losses	2,993	—	2,993
(Recapture of) provision for covered loan losses	(3,072)	—	(3,072)
Non-interest income	10,085	24,412	34,497
Non-interest expense	77,092	10,839	87,931
Income before income taxes	22,180	18,358	40,538
Provision for income taxes	6,942	7,343	14,285
Net income	15,238	11,015	26,253
Dividends and undistributed earnings allocated to participating securities	197	—	197
Net earnings available to common shareholders	$15,041	$11,015	$26,056

	Six Months Ended June 30, 2013		
	Community Banking	Home Lending	Consolidated
Interest income	$197,306		